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PROMPT PAYMENT ACT AMENDMENTS OF 1987

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 328

TO AMEND CHAPTER 39 OF TITLE 31, UNITED STATES CODE, TO REQUIRE THE FEDERAL GOVERNMENT TO PAY INTEREST ON OVERDUE PAYMENTS, AND FOR OTHER PURPOSES

MARCH 19, 1987

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PROMPT PAYMENT ACT AMENDMENTS OF 1987

THURSDAY, MARCH 19, 1987

U.S. Senate,
Committee on Governmental Affairs,
Washington, DC.

The Committee met, pursuant to notice, at 2 p.m., in room 342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee presiding.

Present: Senators Glenn, Sasser, Trible, Cohen, Pryor, Roth, and Levin.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman **Glenn**. The hearing will be in order.

I am pleased to welcome my colleague, Senator Sasser, and invited witnesses to today's hearing on S. 328, the Prompt Payment Act Amendments, which are aimed at improving the Government's record of untimely payments to its own contractors.

The Government's continuing failure to meet its prompt pay obligations is an important problem for both small and large businesses.

Some part of my own checkered past was in the business world, and I was president of an international corporation for a while, and we dealt with contractors, subcontractors, and were subcontractors to other people. So I know a little bit about this as a former businessman, and I know how crucial cash flow is.

If a business cannot depend on timely payments, or is not adequately compensated with interest for the tardiness of those payments, its accounts receivable can be devastated.

Many businesses have not only been hurt financially by the all too frequent lack of dependability, they have also become less willing to contract with the Government again, and I do not blame them.

When the Prompt Payment Act was passed in 1982, its supporters in Congress, myself included, had great expectations for the new law's ability to force the Government to improve its bill paying performance.

In many respects, the Government has done a better job. In some very important respects, however, it continues to fail miserably.

Now it is clear that Government agencies either deliberately, or as a result of inefficiency, are continuing to exploit loopholes in the 1982 Act.

In August 1986, a GAO audit of Government payment practices over a 4-month test period revealed that agencies paid only about 75 percent of invoices by the due date, and that five of every six vendors that were entitled by law to interest payments did not receive them.

Moreover, the GAO report indicated that almost 19 percent of all payments are being made during the 15-year grace period allowed under the law. This was hardly Congress' intention.

A grace period was meant to be reserved for those relatively rare instances when timely payment is impossible. There is widespread agreement about the need for changes in the original law.

The GAO report, coupled with an abundance of anecdotal evidence from vendors, indicates that although the Prompt Payment Act has improved Government payment practices, it needs further strengthening. I strongly believe that the bill we will be discussing today, S. 328, will make the necessary adjustments.

It would, for example, clarify the act's "payment clock" by more clearly defining the "receipt of invoice" trigger. That has been one area of difficulty.

In addition, it would gradually phase out the grace period under which the Government has been able to avoid paying penalties on late payments.

The act's intention that those penalties be automatic would be clarified under S. 328 and substantially greater penalties would be allowed.

That is basically the reason for today's hearing, to take a close look at the law and its deficiencies, and to scrutinize the remedies prescribed in S. 328, a bill which many of my colleagues and I have cosponsored. I want to particularly commend my colleagues on the Committee, the original cosponsors of this legislation, Senators Sasser and Trible, for their efforts in this area.

Senator Sasser submitted S. 328 on behalf of all of us who signed on as cosponsors. I was glad to be a cosponsor. Senator Sasser has been very much concerned, I know, personally, from talking to him, that the Government operates in two directions. We have a responsibility to people, as well as demanding that their products be delivered on time. And we lean on contractors to do that, and lean on them to make sure that every dollar spent is getting a fair product return back.

But, on the other hand, as Jim has pointed out repeatedly, it is also up to us to make very certain that we treat fairly the people with whom we are dealing, too, so that the Government has some credibility in this area. That credibility is too often lacking right now.

So I compliment him very, very much for his efforts through the years on this, for submitting the new legislation, and I am glad to turn over the chair for today's hearing to him. I know that he will be conducting this hearing in a way that will add to our legislative history on this subject. We hope we can get this through expeditiously this year and not wait over for another year.

Before we proceed, I would note for the record that Senator Heinz has submitted his statement for the record.

[The opening statement of Senator Heinz follows:]

OPENING STATEMENT OF SENATOR HEINZ

Mr. Chairman, I am very pleased that we are having this hearing on S. 328, and commend you for holding it. Prompt pay legislation not only makes good sense, it makes for good government.

As a cosponsor of this legislation in the 99th Congress, and again in the 100th Congress, I am sorry we have not passed this measure by now, and gone on to other things. Nevertheless, prompt payment is essential if the government is going to be a reliable business partner. Our contractors deserve fair play, they deserve to be paid when they finish their work.

With that in mind, I am very disappointed that Federal agencies, and the Department of Defense in particular, have seen fit to flagrantly ignore the spirit of the 1982 Prompt Payment Act. In order to avoid the payment of interest penalties, agencies have simply made late payment to contractors and never paid, or even notified contractors of, interest due.

Those who have dashed the intent, if not the language, of the 1982 act have forced Congress to take a strong response. The legislation before us will close the loopholes which agency officials have driven through, at full speed, unfairly denying payments to contractors all the while. I refer specifically to provisions which make explicit the Act's intent that late payment penalties be paid automatically, and the provision for increased penalties when agency personnel withhold late payment interest.

To conclude, Mr. Chairman, I am looking forward to rapid enactment of S. 328. I also want to commend the sponsors, particularly Senator Sasser and Senator Trible, for their hard work on this topic.

Chairman **GLENN**. Jim, it is all yours.

OPENING STATEMENT OF SENATOR SASSER

Senator **SASSER** [presiding]. Well, thank you very much, Mr. Chairman, and before turning to my colleague, Senator Trible, I want to commend you, Mr. Chairman, for moving expeditiously to consider S. 328, legislation which I introduced earlier this year with 54 cosponsors, and which Senator Trible has shown a great interest in, a continuing interest, I might say, in prior years.

This legislation, which has the support of 74 of our colleagues, continues efforts that were begun in 1981, to get the Government to pay its bills on time.

As the original promoter of the prompt payment idea in the Senate, I am particularly interested in making sure that we deliver on the promise that was implicit and inherent in the Prompt Payment Act, and that is that the Government will pay its bills to those businesses that it contracts with, and that it will pay its bills in a timely manner as a good citizen should.

Now, fulfilling this promise has remained an important issue in the eyes of many. We need only look at last summer's White House conference on small business to see the significant attached to the Prompt Payment Act by the small business community in this country.

The delegates to that conference considered more than 400 issues that directly affected small business. They ranked needed improvements to the Prompt Payment Act as one of their final recommendations.

Now the importance that is attached to the Prompt Payment Act by our business community, particularly the small business community, is easy to understand.

Cash flow, as the chairman has indicated, is the life blood of any business. It is especially critical to those small businesses that have smaller profit margins, but that contribute enormously to the vitality of this Nation's economy.

While big business has been losing jobs over the past 8 years, small business has been making up the difference and creating the majority of the new jobs in this economy.

But delinquent payments on Government contracts set up a life-threatening block in the cash flow of small firms, and also large firms.

When we passed the Prompt Payment Act in 1982, we were of the opinion then that we had eliminated a major obstacle to the prompt payment of the Federal Government's basic financial obligations, and I am glad to say that we have seen marked improvements in the payment practices of many agencies.

But unhappily, some branches of the Government and some of our more obstructionist civil servants, I am sorry to say, have managed to find loopholes in this Act.

They have used those loopholes to continue paying bills late and to avoid paying interest penalties as prescribed by the statute passed in 1982, and thus avoid paying the interest penalties altogether.

The General Accounting Office has determined that 25 percent—that is a full one-fourth of payments that are due to be made by the Federal Government—are made late, and are not made in a timely fashion.

In addition, five out of the six companies that are due interest penalty payments because of late payments by the Federal Government were not receiving those interest payments, according to the General Accounting Office.

Now, these actions by agency officials completely undermine the Prompt Payment Act, and tragically, while these defects have been apparent for some time, the administration simply has not moved to curb the delaying tactics that are so destructive to the very backbone of our national economy, and that is our small business community.

The inaction continues, despite repeated assurances to congressional Committees, that loopholes in the Act would be closed administratively, and that it would not take legislative action.

That is why we are here today. That is why remedial legislation is necessary, because we have not seen the steps taken to close these loopholes administratively as we had been promised.

Businesses across this country can no longer wait for the checks, but they have been told over and over again when they call, "The check's in the mail." American businesses, large and small, need action, and they need action now.

The legislation that we are considering today seeks to provide that relief, to close the loopholes which have undercut the effectiveness of the Prompt Payment Act.

So I want to again commend the Chairman of the full Committee for moving swiftly to deal with these lingering problems. I want to commend my colleague, Senator Trible of Virginia, for his efforts along the way in the fight for getting the Federal Government to pay its bills on time.

And it is my hope that today's testimony will underscore any areas in S. 328 where additional attention is needed. It is my further hope that we will take this hearing record and aim toward the earliest possible markup of this legislation.

[Senator Sasser's prepared statement follows:]

PREPARED STATEMENT OF SENATOR SASSER

Mr. Chairman, I am very pleased that the governmental affairs committee is moving swiftly to consider my legislation amending the Prompt Payments Act. My Bill, S. 328, makes much needed improvements to this important Act. And I might add, it makes changes that are long overdue.

The Prompt Payment Act speaks to one of the most pressing problems facing businesses which contract with the Federal Government—getting paid in a timely manner. The problem of late payments on Government contracts severely cut the cash flow of both large and small businesses. Firms were being forced to wait 60 or 90 days, or longer, to receive payment on work they had performed for the Government. While these firms waited for their check from the Government, they often had to scramble to find operating capital. This was especially true of small businesses for which adequate cash flow can mean life or death.

To address these problems, the Congress began considering legislation to ensure that the Government paid its bills on time. I take pride in being the first to promote the prompt payment idea in the Senate back in 1981. Members of the Governmental Affairs Committee took the lead in pushing for the passage of the Prompt Payment Act in 1982.

And that Act has been very instrumental in improving the bill paying practices of Federal agencies. Our testimony today will illustrate that we have made great strides in this important area.

However, we will also hear that there is much left to do to deliver on the promise inherent in the Prompt Paymewnt Act. For tragically, we have seen continued efforts by some agencies and Federal bureaucrats to avoid the intent of the Prompt Payment Act. These officials have managed to find loopholes in the Prompt Payment Act by which to avoid the law's requirements. They continue to make payments extremely late. They continue to avoid making interest penalty payments when they are due.

The General Accounting Office completed a study last summer which underscores the magnitude of these continuing problems. In this study, the GAO estimated that fully 25 percent of Federal vendor payments were made late. In addition, the study found that required interest penalty payments were seldom made. Five out of six penalties owed went unpaid in this study.

Clearly, such actions serve to frustrate the intent of the Prompt Payment Act. They also continue to jeopardize those firms which contract with the Federal Government. The importance of closing these loopholes was underscored at the 1986 White House Conference on Small Business.

The White House Conference drew small business persons from across the country to discuss issues of importance to that sector of our business community. The delegates considered some 400 issues during the conference. Of these 400, a final 60 recommendations were reported out by the delegates. Needed improvements to Prompt Payment Act ranked as final recommendation number 32 at the White House Conference.

With the problems in the Act readily apparent and with the level of importance attached to these problems by America's business community, one would think that the administration would have moved swiftly to rectify these shortcomings. Indeed, if one looks at the statements of administration officials at congressional hearings on the Prompt Payment Act, this impression is strengthened. Last summer, administration officials repeatedly promised administrative remedies would be pursued to close loopholes in the act.

Well, it's been nearly 10 months and precious little action has been taken by the administration. It is clear that a legislative remedy to the problems plauging the prompt payment is in order. I was pleased that 54 of my colleagues, including Senator Trible, the primary sponsor of prompt payment legislation in the 99th Congress, joined in introducing S. 328. I am even more gratified that the list of cosponsors has continued to grow to the present number of 74. The overwhelming support for this measure underscores our commitment to closing the loopholes in the Prompt Payment Act.

Our legislation makes significant improvements in several key areas. We clarify ambiguities in the act as to when the 30-day clock begins to run. I believe our new standard for starting the payment clock will remove one important loophole which agency officials have been able to exploit. I will be very interested in hearing what our witnesses have to say about this new standard.

Equally important, S. 328 gradually eliminates the 15-day grace period presently in the act. Some agencies have been using the grace period to extend payment terms. The net effect has been that where Congress envisioned a 30-day payment period in the 1982 act, we are seeing some agencies use the grace period to extend the payment period to 45 days. By phasing out the grace period gradually, I believe we address the concerns of some that agencies are not ready to move immediately to a 30-payment period.

We have also seen some agencies avoid interest penalty payments by simply not including them in checks to vendors, even when due, or by withholding such payments until a specific request is made by the vendor. The Government bureaucrat gambles that a business will not go through the trouble to request the interest penalty payment if they have received the underlying payment.

Our bill addresses these problems in two ways. First, we make it abundantly clear that interest "shall be paid without regard to whether the business concern has requested payment of such penalty." This was the intent of the 1982 act, but our new language removes any lingering doubt. We also assess a double interest penalty payment in certain situations. It is our hope that this provision will act as a deterrent to any agency officials seeking to circumvent the act's provisions.

We have also seen that some agencies have taken the view that the Prompt Payment Act does not apply to progress payments, particularly progress payments on construction projects. S. 328 clarifies the act's intent in this area by making it clear that the act's provisions do indeed apply in such cases.

We also address the problem encountered in early payment discounts. Some agencies have continued to take discounts which firms offer for quick payment, even though actual payment is not made until after the discount period agreed upon by the parties. Our legislation more clearly defines when the Government can make use of early payment discounts.

One of the bill's more controversial provisions is section seven which requires that contracts between prime and subcontractors on Federal construction projects include a payment clause that provides for payment according to prevailing industry standards. This section has draw a good deal of criticism from general contractors and a good deal of support from subcontractors. I will be particularly interested in the remarks of the panel focusing on this issue today.

Finally, our legislation clarifies what must be included in the annual reports on the Prompt Payment Act prepared by the Office of Management and Budget. Our provisions begin to make the record of the acts implementation more thorough. I will be interested in whether our witnesses believe we need to go further in this area as well.

In short, S. 328 makes some much needed improvements in the Prompt Payment Act. The need for such improvements is now. Our business community cannot afford to wait for administrative cures which may never materialize. Therefore, I am very pleased that this committee is moving expeditiously to consider S. 328. It is my hope that we will take today's hearing record and move quickly to a mark-up session. I believe we can report this bill out to the Senate floor in very short order. I will work with the chairman and my colleagues on the committee to see that we do so.

Senator **Sasser**. I want to turn now to Senator Trible for any statement that he might wish to make.

OPENING STATEMENT OF SENATOR TRIBLE

Senator **Trible**. Mr. Chairman, I thank you very much. I am pleased to join you, and Senator Cohen, as a Member of this Committee for the first time, and continue the effort to ensure the Federal Government pays its bills promptly.

Mr. Chairman, simply stated, the issue before the Committee today is good business, good management, and good Government. Bill paying procedures in the Federal Government need to be improved. While great progress was made as a result of the Prompt Payment Act of 1982 there remains much to be done.

Last year the Small Business Committee, on which I served; compiled an extensive hearing record, some 623 pages of testimony, outlining continuing problems with the implementation of the Prompt Payment Act.

The General Accounting Office reported that agencies paid only 75 percent of their invoices on the date due. GAO also reported that Federal agencies paid only one in every 6 interest penalty when they are actually owed.

Far too often contractors wait months before receiving any payment for goods and services rendered to the Federal Government, despite the statutory requirement that they be paid within 30 days. No firm wants to encounter financial problems created by late payments. The Federal Government is becoming the customer of last choice for many private companies.

Fewer and fewer firms opt for Government work. In short, poor payment practices result in a no-win situation for everyone, from the businessman, large and small, for Government, for taxpayers.

Fortunately, we are working to resolve those problems. Last year the Senate unanimously passed legislation that I sponsored to reform the Prompt Payment Act.

Senator Cohen provided decisive leadership in ensuring that this Committee act promptly in the last Congress. Unfortunately, time constraints at the end of Congress prevented the House from acting on this measure.

Today, we all continue those efforts. My distinguished colleague from Tennessee, Senator Sasser, has introduced the reform legislation this year. We join him in that effort, and I am confident that the groundwork has been laid for timely enact of a prompt payment reform measure.

I look out today in this audience, and I see many people, Mr. Chairman, who have stood with us, who have provided helpful ideas, and who have helped shape this legislative proposal.

I applaud their leadership and I look forward to hearing from each of them today.

[Senator Trible's prepared statement follows:]

PREPARED STATEMENT OF SENATOR TRIBLE

Good morning. I am pleased to be here today. Along with many of today's witnesses, I have been working together for well over a year developing legislation to reform the Prompt Payment Act. I want to take this opportunity to thank them and their organizations for their efforts on behalf of prompt pay reform.

I want to underscore my commitment to reforming the Federal Government's bill—paying practices. During the 99th Congress, the Small Business Committee conducted extensive hearings of the Prompt Payment Act. In the 100th Congress, the Governmental Affairs Committee is continuing efforts initiated last year. I'm pleased that I was able to change committee assignments in time to participate in today's hearings.

Mr. Chairman, simply stated, the issue before the committee today is good business, good management, good government. Bill-paying procedures in the Federal Government need to be improved. While great strides have been made in this area as a result of the Prompt Payment Act of 1982, there remains a gap between what we did in 1982 and what agencies are doing today.

The Small Business Committee compiled an extensive hearing record last year, some 623 pages of testimony, outlining continued problems with implementation of the Prompt Pay Act. In addition, the General Accounting Office reported that agencies paid only 75 percent of their invoices by the due date. GAO also reported that Federal agencies paid only one in every six interest penalties that were actually owed.

Far too often, contractors wait months before receiving any payment for goods and services provided the Federal Government, despite the statutory requirement to pay them within thirty days. No firm wants to encounter the financial problems created by late payments. The Federal Government is becoming the customer of last choice for private companies and fewer and fewer firms opt for Government work. In short, poor payment practices result in a "no win" situation for everyone.

Fortunately, we are working to resolve these problems. Last year, the Senate unanimously passed legislation I sponsored to reform the Prompt Payment Act. Time constraints at the end of the Congress prevented the House from acting on this measure.

Today, we continue our efforts. My colleague, Senator Sasser, has introduced reform legislation virtually identical to the measure which passed the Senate last year. And, I am confident that the groundwork has been laid for timely enactment of a prompt pay reform measure.

Mr. Chairman, I appreciate your interest in this matter and I look forward to hearing the views of the witnesses.

Senator SASSER. Thank you, Senator Trible. Senator Cohen, do you have an opening statement?

OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. I would ask unanimous consent that my statement be included in the record.

[The prepared statement of Senator Cohen follows:]

STATEMENT OF SENATOR COHEN

Prime contractors, subcontractors, suppliers, service contractors, large businesses and small businesses have one common gripe—they cannot depend on the federal government to pay their bills on time.

I am a cosponsor of S. 328, the Prompt Pay Amendments of 1987, which is the subject of this hearing. This bill is designed to close loopholes in and improve the implementation of the original Prompt Pay Act.

We currently have a law on the books which is supposed to ensure that the government pays its contractors in a timely manner. If it fails to do so, the government must pay interest on the overdue amounts. Generally, an agency is supposed to pay a prime contractor within 30 days after receipt of a proper invoice.

Slowly but surely, the government is beginning to pay its bills on time. The problem is that the current law is not working well enough. Senate hearings held last Congress revealed that agencies still pay nearly 25 per cent of their bills after the due date. Agencies often abuse the "grace period" by routinely paying invoices within this extended period and frequently fail to pay the interest penalty on late payments. In fact, some agencies have a policy not to pay interest owed unless asked by the contractor.

These practices should not be tolerated. Last year the Senate passed the Prompt Pay Amendments of 1986 to fix these problems, but the amendments were not enacted into law. Thus, this year I have joined 76 of my colleagues in sponsoring S. 328, the Prompt Pay Amendments of 1987.

Virtually identical legislation was passed by the Senate at the end of the 99th Congress. It received no action in the House, but it is my hope that this bill will be approved by both chambers this year.

I understand that some of our witnesses here today oppose a provision of S. 328 that would bring subcontractors within the coverage of the Prompt Payment Act. This provision would require prime contractors to pay their subcontractors in accordance with prevailing industry standards. I believe that there are compelling reasons for subcontractors to enjoy the same assurance of timely payment that prime contractors are extended under federal law. I am, however, open to hearing their views on this issue in an effort to make the system of payment for government contracts fair to all parties involved.

As the former chairman of the Governmental Affairs Subcommittee on Oversight of Government Management, I had a hand in crafting this bill and I am convinced that a legislative solution is necessary. I would like to commend Senator Trible and Senator Sasser for their leadership role in this important initiative, as well as the Small Business Committee, which developed an extensive hearing record to support the need for the legislation.

Senator COHEN. Mr. Chairman, I would perhaps just offer one observation. One of the more controversial provisions included in this legislation is the application of the Prompt Payment Act to subcontractors as well, and that is something that I think is very important.

You can make a very compelling case that if our contractors are entitled to be compensated for their work and services promptly, the same rationale applies to those who have provided services to them.

Now there may be some legitimate reasons why this is not so in every case. There may have to be modifications to the existing legislation, but I think the burden is upon those in the business of contracting to demonstrate to the Committee why it is that subcontractors should not enjoy the same sort of prompt payment as we would insist upon for the contractor.

Senator **Sasser**. Thank you, Senator Cohen.

Senator Pryor, do you have an opening statement or comment you would like to make?

OPENING STATEMENT OF SENATOR PRYOR

Senator **Pryor**. Mr. Chairman, like Senator Cohen, I would like to ask unanimous consent that the full body of my statement be printed in the record.

[The prepared statement of Senator Pryor follows:]

PREPARED STATEMENT OF SENATOR PRYOR

Mr. Chairman, I am pleased the Committee is today holding hearings on a subject of great importance to the small business community: the absolutely critical need for the federal government to pay its bills on time. Mr. Chairman, I want to commend you, a well as Senators Sasser and Trible from this Committee, for all your leadership in this area.

I also want to note the leadership of the senior Senator from Arkansas, Senator Bumpers, who has great interest in this legislation in his capacity as chairman of the Small Business Committee. I have several questions which I intend to submit for the Record on behalf of Senator Bumpers.

Mr. Chairman, I supported the 1982 Prompt Payment Amendments and I'm proud to have done so. Nevertheless, like all good things, you can never get enough. Although the Act has brought about significant improvements in the bill-paying record of Uncle Sam, there is room for improvement, refinement, and clarification of the law. Hence, the need for this bill.

For the most part, I consider the changes to the law which are incorporated in S. 328 to fall under the category of technical amendments. Last time I checked there were 73 cosponsors of this bill. Although I'm sure if you put all 73 of us in a room together we could not agree on what must be done to solve the bill paying-problems of the federal government, I think it is important that a consensus exists in the Senate to see that the legislative intent of the original act is not somehow avoided through "creative" countermoves by federal agencies which don't want to pay on time.

I am also aware of a controversial portion of the bill, section 7, about which there are apparently strong feelings on two sides. I am pleased to note both sides are represented here today, and thrust they will be able to present their views so Congress can make a determination and get on with the critical task of making the government a responsible business partner.

Thank you, Mr. Chairman.

Senator **Pryor**. I also, Mr. Chairman, think momentarily, that I will have some questions put in the record to be answered at a later time on behalf of my colleague from Arkansas, Senator Bumpers, who has a great interest in this legislation.[1]

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[1] Senator Bumpers' questions incorporated into questions submitted to witnesses on behalf of the Committee by Senator Sasser.

I do not have those now. I think I will, shortly. Also, Mr. Chairman, I want to commend you for holding these hearings, and I think that the concept of this legislation is very sound.

I am also extremely aware, as I know the members of this Committee are aware, of one controversial portion of the bill. That is section 7, and I am glad that we have individuals with feelings which are very strong, representing both sides of the issue on duty today, ready to educate us on their respective positions. I look forward to hearing that testimony.

I thank you very much, Mr. Chairman.

Senator SASSER. Thank you, Senator Pryor.

Our first witness today will be Mr. Kenton Pattie, the director for the Coalition for Prompt Pay.

Mr. Pattie, I want to ask you, and all witnesses today, to limit your oral remarks to 5 to 7 minutes.

Your written statement will be included in the record in its entirety. We have a large number of witnesses today. We have got lots of ground to cover, so that is why I am asking the witnesses, if at all possible, to limit their opening remarks to 5 to 7 minutes. Mr. Pattie.

TESTIMONY OF KENTON PATTIE, DIRECTOR, COALITION FOR PROMPT PAYMENT [1]

Mr. PATTIE. I certainly will try, Mr. Chairman, and I want to thank you very much for having this hearing on this subject. I want to thank Senator Glenn, as Chairman of the Committee, for holding the hearing so quickly in this session of Congress.

Senator SASSER. If you will just for the record identify yourself, and who you are with, Mr. Pattie, for the reporter here.

Mr. PATTIE. I am Kenton Pattie. I am the director of the Coalition for Prompt Pay and I am also the senior staff vice president of one of the members of the coalition, the International Communications Industries Association.

I would also ask consent of the Chairman to place into the record some statements that I have been asked to bring with me in support of the bill today from the National Association of Credit Management, the Mechanical Contractor's Association of America and the American Logistics Association, and I also request permission to have appear in the hearing record an article that appeared in the Washington Post on Saturday. The title of it is, "State Department: Slow to Pay." [2]

Senator SASSER. Without objection, it will be included in the record.

Mr. PATTIE. I would like to open just by expressing the appreciation of the Coalition to you, Senator Sasser. I recall your introducing one of the first prompt pay bills in the Senate many years ago. You have been stalwart in pursuing this issue over the years.

You went after the Navy when, as a Member of the Appropriations Committee, trying to get them to improve their payments, and we are very grateful for your taking the leadership on this this year.

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[1] See p. 74 for Mr. Pattie's prepared statement.

[2] See p. 108.

I also want to thank Senator Trible. Senator Trible has become something of a folk hero among small businesses in Virginia because he championed this issue. He took it up very quietly back in Norfolk, Virginia a couple years ago, introduced a bill to gather the information needed to bring us to the point where we are today, and we are very grateful to you, Senator Trible, for taking that leadership.

Senator PRYOR. Mr. Chairman, is this witness being paid?

Senator SASSER. No; but he is doing an awfully good job. [Laughter.]

Mr. PATTIE. Senator Pryor has been very faithful——[Laughter.]

Senator Pryor, you have cosponsored the bill. You have made statements in the Congressional Record. You have supported us at every step. And Senator Cohen has chaired the Subcommittee that spent many hours last year in marking up this bill, working on it, considering all the views, and we are just really very grateful. It is rare, as associations, that we get a chance to thank the people that are helping us, and I like to do it here because we have so many people in the room that——

Senator TRIBLE. You are off to a good start, Mr. Pattie.

Senator PRYOR. We love praise. [Laughter.]

Mr. PATTIE. I would like to just summarize a few of the portions of the bill that directly, I think, affect all businesses, and, in preface, I would like to say that this bill, while we are talking about helping businesses, this bill and the Act that it amends, are designed, really, to make Government more efficient, to make the Government a better business partner, and to cut down on red tape and bureaucracy in the U.S. Government.

With respect to acceptance, which is the first major provision in the bill, of all of the problems we have had, it has been in getting the 30 days to begin. In the 1982 act we said we wanted all bills paid in 30 days, but the problem has been in getting the Government to decide when that 30-day clock begins.

The General Accounting Office said that 36 percent of late payments are caused by the receiving agencies, and that must be a low estimate, because they found that in 66 percent of the 39 centers that they interviewed, that they did not even have the data on when the receipt was made by the agency, and all the paperwork and so forth. So it could be far more than 36 percent.

So this bill, S. 328, which we support, in section 3, contains a provision that says that you, the Government, have just 5 days to receive and accept the goods.

Frankly, in the commercial marketplace, 30 days is the standard. Bills submitted should be processed and paid within 30 days.

So what we are doing here is giving an additional 5 days to the Government. Unfortunately, in the past, they have taken months, so the 5 days looks good in comparison to the months, but it is in excess of the commercial standard.

I notice that the FAR draft—and the committee, incidentally, should be congratulated. You have managed to stimulate the administration to rush up to us anew FAR draft which arrived yesterday.

Also breathlessly rushed up to you was the annual report from the Office of Management and Budget, which the 1982 act requires.

However, it arrived late, but I again congratulate you for having stimulated them to arrive here. And I dare say, on late reports from OMB, if there was an interest penalty charged for being late, that perhaps they might be able to manage to meet the goals of the Act, and be on time!

But I notice in that FAR draft that it says "Agency heads are authorized to prescribe alternative clauses which stipulate different due dates on invoice payments," and if that in fact means that no matter what we do here with this bill today, that the administration, or the executive branch, would have the authority to waive that and set other due dates, and other payment arrangements, then I think the FAR that draft that we are looking at—which we are all going to be examining—will undermine what we are trying to do on this committee, and what we have already done with the 1982 act.

With respect to the grace period, I had a chance to glance through the OMB testimony, and I believe I understand that they will testify today that they welcome the removal of the grace period.

The GAO found that of late payments, 33 to 77 percent of the late payments were paid during the grace period. We were opposed to the grace period in 1982.

The grace period was not in the Senate version of the bill in 1982, as Senator Roth will recall, and we have been opposed to the grace period, and this bill simply eliminates the grace period over a period of time, ending by 1990.

And I know that OMB will testify that they should be able to do it in shorter than 1990, in which case you might even consider amending your bill to have the deadline shortened, if they are able to actually accomplish that goal in shorter than the 8 years since the enactment of the 1982 Act.

With respect to automatic payment of interest penalties, the General Accounting Office estimated that there were 278,000 unpaid interest penalties that the 1982 Act required in just 4 months.

This would have amounted to $15 million in interest penalties during the 4 months, and the last OMB annual report to you said that they had paid only $7 million in interest in one year.

So there is a tremendous amount of interest penalties that is not being paid out to companies under the 1982 Act, but which should have been paid.

The bill before you, in section 4(b) and (c), will resolve that problem, and their having been reluctant to make these payments of interest, will double the penalty, and I think the result of that, as required by this Act, will cause them to pay up. They will no longer be skipping these interest penalties but will pay them.

With respect to progress payments and retainage, this is something that I think everybody felt was covered in the 1982 Act. The agencies, one by one, have consistently said, "We will not pay under the Prompt Payment Act for progress payments, and we will not pay interest penalties."

We have objected to that. The Office of Management and Budget tried in an obtuse way to try to encourage the agencies to do something about it. They have not.

I think the only solution to that problem is through this bill, and I hope that the Office of Management and Budget will welcome this because I think we are helping them get done what they have been unable to do themselves.

With respect to early payment discounts, a continuing problem, I spoke at a meeting recently where I asked the companies if they were having this problem. Every single person in the room raised their hand and said "Yes, we are having this problem".

The companies offer discounts. The Government takes the discounts. But, the Government takes them months after the discount period has expired.

The General Accounting Office estimated that 146,000 discounts had been taken unfairly by the Government. This bill clarifies this, and I think, as a result of this bill, I think this problem will be ended.

With respect to the annual report, in my testimony I have made some suggestions for additional provisions for the annual report that you get. I think the more we learn about this, the more detailed information we want to get from the Office of Management and Budget.

The bill does have some very good provisions in it which we support, and there are some additions that I have mentioned on page 13 of my testimony, which might improve the report that you get, give you a better idea of how to conduct a future oversight hearing on this subject.

With respect to section 7, I know we are going to hear a lot about that later on during the hearing. I would just like to say that I have worked on prompt pay for many years. This is I think my ninth year on the subject. And since the 1982 act, the most complaints that I have had, outside of the provisions I have already mentioned above, coming to me as director of the coalition, have been in the area of subcontractors saying, "Kenton, you did a great job for the general contractors, you did a great job for the prime contractors, but now what about us? We are left out of this thing. We are still getting paid late. What are you going to do about it?"

And I think, personally, that section 7 has responded directly to this.

I know that Senator Trible and Senator Cohen worked very hard with Senator Roth last year in working this out, and I think section 7 does make a fair response.

It does not involve the government directly in a contract relationship between two parties, but simply extends down to the subcontractor the same payment that is received by a general contractor.

It extends down the right to the subcontractor, who did the work in the first place, to get the payment. I might mention that some of the members of the Coalition for Prompt Pay do not have a position on this. Some of the members in my coalition are neutral on this. But the majority of the members of the Coalition feel keenly that section 7 is a strong and creative solution to the problem that our subcontractors are having.

Therefore, we support it. One other area, and then I will complete my statement, Mr. Chairman.

That is that we recommend, as a coalition, as I have noted in attachment 3 of my testimony, that there be a provision added dealing with Federal assistance.

This came up in 1981 when this Committee first dealt with this bill. It was a matter of Job Corps centers—and other intermediaries that were administering Federal money. They were spending Federal money. They were doing things with Federal money, but the Prompt Payment Act did not apply.

There is a provision in the 1982 Act that deals with this, but it has not proved to be very effective, and we recommend that there be language added that would strengthen this provision.

And I might point out that 19 States have done this same thing. There are 19 States that have required not only prompt payment by a State agency, but also, prompt payment by those municipalities, counties and cities that are administering State money.

Those nineteen include Alaska, Delaware, Michigan, and Virginia, and 15 others. That concludes my statement, Mr. Chairman.

Senator SASSER. Well, thank you very much, Mr. Pattie. I note that we have been joined here by the distinguished ranking member of the full Committee, and I wonder if he has an opening statement or a comment that he would like to make at this time.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Thank you, Mr. Chairman. I would ask that the full text of my opening statement be made a part of the record.

Senator SASSER. Without objection.

[The prepared statement of Senator Roth follows:]

STATEMENT OF SENATOR ROTH

Representing a smaller state as I do, I imagine that I am particularly sensitive to the treatment of things that are small, whether they be individual interests or groups or institutions. In this vein, I believe that the health and prosperity of small business is absolutely vital to our economic health as well as to the sense of community in our nation.

Small business is the vast job creating machine in our economy, far outstripping the job creating capacity of larger corporations. Small business is a major source of innovation in our society, providing strong impetus to our newfound interest in competitiveness. And small businesses provide the foundation for the strong sense of community that we value to highly in our nation.

Mr. Chairman, the legislation we focus on today, while it will benefit all firms doing business with the Government, essentially is a small business bill. It is designed to clarify and strengthen the legislation we passed out of this Committee in 1982 that encourages Federal agencies to pay their bills on time. I commend you, therefore, for holding this hearing so early in this first session of the 100th Congress. I suggest that we make whatever changes are necessary based on today's hearing record, move the bill to a Committee vote and seek early consideration on the Senate floor. I can think of no more important action that the Congress can take to ensure proper government treatment of small business than timely action on these Prompt Payment Act amendments.

I am pleased to join Senator Sasser by co-sponsoring S. 328 in the new Congress, and I particularly want to applaud the time and effort that Senator Cohen and Senator Trible devoted to this initiative in the last Congress. It is my hope that we can build on this foundation and present a bill to the House in the early spring for its consideration.

By virtually all measures, the original Prompt Pay Act has vastly improved the payment practices of the Federal Government. The General Accounting Office (GAO) and the Office of Management and Budget (OMB) have substantiated this in their analyses. And I have had this impression verified by the small contractors who have spoken to me.

Yet despite these improvements, problems persist. The little guy, operating on a small margin with no staff to track down late payments, is too often left out in the cold when a Federal agency cannot get its paperwork act together. Hearing evidence indicates that Federal agencies continue to pay nearly 25 percent of their bills after the due date and often fail to pay the interest penalty required by law. Certain agencies abuse the 15 day grace period in the Act, routinely paying invoices between the 8th and 14th days of this extended period.

S. 328 addresses these and other concerns by clarifying provisions and strengthening provisions of the original Act. And it sends a clear message to the agencies and OMB that the Senate is adamant about full compliance with the prompt pay provisions. While I understand that some concerns remain with the section 7 subcontractor provision of the proposal, I trust that these concerns can be dealt fairly and expeditiously. I hope that the statements presented today will guide us in this process.

Mr. Chairman, I look forward to receiving the record that the Committee will establish today as I look forward to working with you to advance this legislation. This is a good bill, it is an important bill and one I am pleased we are devoting this time to today. Businesses, particularly the small firms, doing work for the Federal Government deserve nothing less.

Senator ROTH. I want to express my appreciation to you, first of all, for sponsoring this bill, S. 328. I was very pleased to join you in that effort, and I also want to express my appreciation to you, Mr. Pattie, and your coalition for what you have done. You people have been the driving force behind this initiative, and it has been a pleasure to work with you.

Last year, Senator Cohen and Senator Trible devoted much time and effort to this effort, and I must confess, that when we passed the earlier legislation I had hoped that we had solved our problem. But one thing you learn around here is that people always find ways and means of avoiding the intention of new legislation, which makes our jobs I guess semipermanent at least.

But I am hopeful that the proposals that we have before us will strengthen the basic provisions of the legislation, and make certain that small businesses, which are entitled to be paid, do not have to endure the indignity of slow payment.

I want to thank you for your contribution.

Mr. PATTIE. Thank you. We share your confidence that this bill is going to do the job, sir.

Senator SASSER. Thank you very much, Senator Roth.

Mr. Pattie, in the prepared statement which you have submitted for the record this afternoon, you note that late payments to contractors, and the exploitation of the ambiguities in the Prompt Payment Act often deny the contractor a late payment interest penalty. And when this occurs you take the position that this harms the Government as well as the contractor.

Now, uncertainty regarding timely payment makes it very difficult for firms to compete effectively in the Federal marketplace. The Government, it has been my experience, demands that the contractor perform in full compliance with the contract terms and conditions, as it should, to protect the taxpayer.

But the contractor has a right to clear payment terms that will be met by the Government, and I have had the experience in my own State of contractors telling me that, "Senator, I don't want any more Government business. I simply can't afford that type of business. I perform the contract according to their specifications, according to their terms, according to their conditions, but I simply can't get paid, and my cash flow situation is such that I can't carry the Federal Government for 60 or 90 or 120 days."

And this has denied, in my view, the Federal Government, the services of some of the most efficient and effective contractors in my area. Would you care to comment on this further, especially from the viewpoint of contractors providing commercial products and services to the Government.

Mr. **Pattie**. Yes, Senator. There is no question that many companies are discouraged from doing business with the Federal Government because of their late payment policies.

I just had a letter yesterday from a person in Ohio we had written, asking if he had had any late pay experiences, so that I could bring it to the committee, and he had written me back saying that he does not—will not ever—do business with the Federal Government because of the variances in their payment policies.

I think the Government loses in a situation like this, so if the Government loses, just as you say, they lose companies that are good companies, that are local companies, they are fine companies, they are small businesses, they would participate if they felt that the Government was going to be a fair and consistent, and a reliable partner.

Senator **Sasser**. Now one of the provisions of this legislation revolves around the time at which the Government accepts the bill for payment, and once the Government accepts the bill for payment then time starts running as to when the bill is due, and then when late payment penalties will attach.

Yet what we have seen on the part of some agencies is dillydallying with the time of acceptance, pushing that further and further off, and using that as a means whereby to avoid certain provisions of the former legislation, which specified what was acceptance, and when the time should start running for payment.

Do you have any comment on what might be done to strengthen up the so-called acceptance provision of the 1982 Act, and would you just give us generally your views, and the views of your colleagues on the Prompt Pay Coalition relative to what would be an effective acceptance provision.

Mr. **Pattie**. Well, Senator, acceptance, it is a big word, but for 99 percent of everything that the Government receives, it is a very simple matter.

They have received it, they are about to use it, they should acknowledge that they have received it. That should be the moment of acceptance, and the 30-day clock should begin.

The bill that you have introduced, and that is before this Committee, would resolve this by allowing the Government 5 days in which to say they got it: "We have touched it, we felt it, we smelt it, and we accepted it." And some time in that five-day period, or certainly by the fifth day, if not otherwise specified in the contract, the 30-day clock would begin, and we feel that is an acceptable way to get at this acceptance problem.

Senator **Sasser**. Have you found, Mr. Pattie, that in some instances the Government is paying more for goods and services than it otherwise would if it paid its bills on time?

By that I mean are some firms actually incorporating in their bill compensation for the lapse in the time that the Government should pay them?

In other words, if you are paying interest on operating capital for 60, 90 or 120 days, when the Government is not paying you on time, have you come across instances when bills were higher, taking into consideration the cost of operating capital?

Mr. PATTIE. Yes, I have. I might say, on behalf of the Government, they work real hard to get the lowest possible price in all instances.

However, immediately following the enactment of the 1982 Prompt Payment Act, a number of companies reported that they were able to reduce their prices because they now knew that they were going to be paid on a regular basis.

In particular, I recall John Lorden at the Office of Management and Budget calling me, excitedly, to tell me that he had just talked to a meat contractor out in Oklahoma who had said that he had begun reducing his prices on meat to the Government because of the Prompt Payment Act.

Senator SASSER. So as a matter of fact, the Government is actually paying more in the long-run, by not paying its bills on time, or that would be the bottom line in many instances, would it not?

Mr. PATTIE. Yes. If you are an inefficient customer, an unreliable customer, the business has to allow some latitude for that, and some of it is going to end up in the price, there is no question about it.

Senator SASSER. Thank you.

Senator Cohen?

Senator COHEN. Just a couple of questions, Mr. Pattie. Do you agree with the GAO observations that the 5-day constructive acceptance date, which marks the start of the payment term, may unnecessarily delay some payments where the receipt of the invoice actually precedes the final——

Mr. PATTIE. As I stated at the beginning, we believe the commercial standard which is 30 days is plenty of time. However, we are supporting this bill in deference to the Government which is always a special and unusual customer, and allowing that additional 5 days, in contrast to the days and months that we have been experiencing up to now.

There is no question that with some payments there could be some delay because the Government automatically takes the 5 days, and then they take the entire 30 days, when they could have easily made the payment in 10, 15, or 20 days.

Senator COHEN. I would like to have you address a couple of the objections raised by the Associated General Contractors, questions about extending prompt pay requirements to the subcontractor. Earlier this morning I had occasion to participate in some hearings on the independent counsel statute and I used a couple of phrases, "malum prohibitum" and "malum in se", a couple of Latin phrases pertaining to the law. Now I find that no one except Archibald Cox understood what I was talking about at the time.

But now one of the claims is that the subcontractor clause in this bill is an unwarranted Government intrusion in the privity of the contract relationship. Would you address that issue, please, and talk about privity first so everybody will know?

Mr. PATTIE. I understand. I look at it from a different way. The Congress has said: we want subcontractors involved in working for the Government. We want subcontractors, small minority-owned businesses. The Small Business Committee, this Committee, other Committees of the Congress have repeatedly said we want small businesses to be involved in the Government work.

And this particular provision is a way that you have of stimulating that small business participation.

This will encourage small businesses to participate. This is not the Government with a heavy hand getting involved directly in a contractual relation between two parties and telling them things that the Government is going to do to them if the two parties do not agree to it.

This is the Government saying: we want small and minority businesses and one of the only ways to get them is to ensure them that they will get paid promptly when the money has arrived at the general contractor's office and can be properly forwarded on to the subcontractor.

Senator COHEN. Are we, in effect, forcing certain provisions to be negotiated between a general contractor and a subcontractor by virtue of this act?

Mr. PATTIE. I do not think you are forcing them to be negotiated. I think you are saying, from the Government's standpoint: we would really like to see this regularly done, because we feel as a result of section 7 we are going to get a lot more subcontractors willing and able to do work for us.

Senator COHEN. There is some notion that this is a unique breakthrough in Government policy, but I think the record would reflect there are about at least 28 different flow-down contract clauses currently required under our Federal regulations.

Mr. PATTIE. That is true, Senator, there are. It is a common practice for the Government to have a variety of different requirements that they want to have extended down to those subcontractors that are serving them.

Senator COHEN. Now, what about the issue of whether or not we are going to embroil the Federal Government in disputes between subs and prime contractors in a lot of litigation?

Mr. PATTIE. I have read the amendment. I read it last year. I read it again before this hearing. I do not see that. I really think that is a red herring as far as the argument goes. I do not see the Government getting involved at all. I think the Government states what it wants and I think from then on it is a matter between the GC and the subcontractor to resolve.

Senator COHEN. Well, the subcontractor is not entitled to get payment until he, she, or it, depending on the structure of the operation, has completed performance.

Mr. PATTIE. That is right. That is exactly correct.

Senator COHEN. And the contractor would have to make a determination before submitting the bill to the Government as to whether that work that was done by the sub was in conformity with Government specifications.

Mr. PATTIE. That is right. If the Government hires a general contractor to look after the Government's business, and to the extent that the subcontractor has done his or her job correctly, that is the general contractor's responsibility to make that determination. And even before the Government releases the money, the Government also has inspectors who go out and look at these projects as well.

Senator COHEN. Would it be possible for the prime contractor to submit an invoice for work done, with the exception of certain smaller aspects of the job, and ask that the Government determine whether payment should be made on those?

Mr. PATTIE. That is why the Government hires a general contractor, to look over the work and only submit proper invoices that the general contractor feels have been completed, are done, and are valid for payment.

Senator COHEN. Does it come down to a question of who should have the float? Whether the Federal Government is having the float now for that 30-plus day period of time, and now with the general contractors being assured payment in that timeframe, is there an issue of whether the general contractors would like to have a little float time as well before passing on that money to the subcontractors?

Mr. PATTIE. I think this, that if a contractor, as a matter of policy, is receiving the money from the Federal Government and it is taking 30 or 40 days, or perhaps longer, based on some evidence that I have seen, to payoff the subcontractor, I think they are enjoying the float, and I personally question whether that should be done.

Senator COHEN. But do you feel that we can at least respond legitimately to the questions they may have? Is there any legitimate issue they might have? For example, if they find latent defects in the work on which there is a challenge, is that not covered by their indemnification clauses?

Mr. PATTIE. The payment itself, the act of payment does not relieve liability under any circumstances, and if it was ultimately found the subcontractor had erred in any way, if the subcontractor has done something incorrectly that was missed by the GC and it was missed by the Federal Government inspector, certainly at any time in the future the general contractor has recourse against the subcontractor to make it whole.

Senator COHEN. Thank you very much.

Senator SASSER. Thank you, Senator Cohen.

Senator Pryor?

Senator PRYOR. Mr. Pattie, one quick question. I sense that within some of the Federal agencies certain employees may well spend a great deal of time and effort, energy and resources, trying to find loopholes so they will not have to comply with legislation like the Prompt Payment legislation. Do you have any idea about how much time they spend figuring out how to circumvent the intent of the Congress?

Mr. PATTIE. I have no evidence to submit to you, but I certainly agree with your assumption that they are going to a lot of trouble to get around this. I know that OMB was, in the early months after the 1982 act, they were concerned about this as well and they did a number of things to admonish the agencies to do a better job in complying.

But when you read the General Accounting Office report that just arrived here last year, you find that the agencies are still very reluctant to get in line. And I think that is why we need this bill, to give OMB the clout to go out there and say look, Congress has said that you have got to get with this now.

Senator PRYOR. I bet you there are Government agencies out there right now staying up late to look at the soft spots, the underbelly of this legislation, to see where they can circumvent the intent of what Congress is trying to do.

Now, Mr. Pattie, where are those soft spots? If you worked for an agency and you did not want to pay your bills on time, where would you be looking in here for an area of softness?

Mr. PATTIE. Well, certainly one of the first things I would do if I was in the Government, I would look at the maximum amount of time that I have got to get this payment made, and under this bill you have got 35 days. And I am going to use every minute of that 35 days. That would be one of the first things, I am sure, that they would want to do.

Senator PRYOR. A final question. Why does the Government not want to pay its bills on time?

Mr. PATTIE. Well, there are actually a variety of reasons. A lot of it has to do not with what you and I would think—save money, ride the float a little more, lighten up the Treasury situation, although OMB has impressed on them through memoranda that they really ought to be mindful of the Federal Treasury and pay the bills as late as possible. A lot of it just has to do with the inadequacy or the lack of clarity of the deadline. It is like you had this hearing here and all of a sudden the Government was able to get a major FAR revision and an OMB report to you on the same day.

You set deadlines, and that is what this bill does. It sets deadlines. And I think that is what is going to get them off the dime on this. Before, they had months to go without a deadline—a clear deadline—and your bill is going to give them the clear deadline.

Senator PRYOR. Thank you very much, Mr. Pattie.

Senator SASSER. Thank you, Senator Pryor. You are indicating that some Government agencies might be looking for the soft spots in this legislation already. How many lawyers did the Post Office Department tell us that they had, just the other day, right here in Washington?

Senator PRYOR. Senator Sasser, we had a hearing in this room Monday, I believe, and the Postmaster General told us that I believe they had in the Postal Service 141 lawyers. And I asked them: Are these good lawyers? Oh, yes, they are from Yale, Harvard and Columbia, they replied. I said, well, if you have all those lawyers and they are all smart lawyers, why is it you pay Joe Califano $600,000 a year to represent the Postal System? I did not get a clear answer. I am still waiting for a clear answer and I hope they will supply it for the record.

Senator SASSER. Well, maybe those lawyers were—most of them were engaged in studying the amendments to the Prompt Payments Bill.

Senator PRYOR. That may be it.

Senator SASSER. It could be. Thank you very much, Mr. Pattie, for appearing here today.

Mr. PATTIE. Thank you, Senator.

Senator SASSER. Our next witness is Mr. Jeffrey Steinhoff, the Associate Director, Accounting and Financial Management Division, of the General Accounting Office of the United States.

Mr. Steinhoff, if you would identify yourself and your colleagues for the record, and then go forward with your testimony. And we would ask you if at all possible to summarize it in 5 to 7 minutes.

TESTIMONY OF JEFFREY C. STEINHOFF, ASSOCIATE DIRECTOR, ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE,[1] ACCOMPANIED BY MEL MENCH AND MARGE LANGE

Mr. STEINHOFF. I am Jeff Steinhoff, Associate Director with GAO. With me are Mel Mench and Marge Lange, who have been instrumental in our work in the bill payment area.

Mr. Chairman, members of the Committee, we are very pleased to be here today to discuss our August 1986 report on bill payment progress and to give our views on S. 328, the Prompt Payment Act Amendments of 1987.

The Prompt Payment Act, passed under the leadership of this Committee, has provided a strong foundation for making the Government a more responsible bill payer. We have seen considerable progress since our initial Government-wide assessment in 1978. Payments made 90 or more days after the invoice date have been reduced by 40 percent, and payments made at least 15 days early have been cut in half.

Reductions in early payments save the Government millions of dollars in interest costs, while fewer very late payments helped ease vendors' cash flow problems. However, there still is a lot of room for improvement. A fourth of the payments continue to be made late, and almost another fourth are paid early.

Agencies generally did not pay required interest penalties nor refund improperly taken discounts. Our report identified key actions needed to improve the Government's bill payment performance. We understand that OMB is working to address these problems and has taken steps to increase the accuracy of its payment-timing report to the Congress. Such reports were seriously misleading in the past.

S. 328 underscores the Congress' insistence that agencies make a full-fledged effort to pay their bills on time. While the Prompt Payment Act has essentially worked well, it needs to be fine tuned based on 4 years of experience. S. 328 should speed up payment in cases where agencies simply take too long to accept goods or services and clarify other issues that have adversely impacted bill payment.

We fully support the concepts in the bill such as: Including prompt payment provisions in the Federal Acquisition Regulation; expanding agencies' reporting requirements; assuming acceptance after 5 days; shortening the grace period; including progress payment terms in contracts; defining receipt of an invoice; voluntarily paying late payment penalties; and establishing the start of discount periods.

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[1] See p. 109 for Mr. Steinhoff's prepared statement.

We are offering today, for your consideration, some technical refinements to the bill, two of which I will now highlight.

First, the 5-day presumed acceptance period provided for in Section 3(a), which we fully support, would decrease late payments caused by slow acceptance and be more fair to vendors. While fully agreeing with the intent, we have some concern that the provision as drafted could unintentionally delay payment when acceptance occurs earlier than 5 days. Also, the provision may be misinterpreted as restricting an agencies right to reject unsatisfactory goods or services after the 5-day period.

We suggest that the bill make clear that acceptance period provisions (1) apply only if actual acceptance has not occurred earlier, (2) are only to be used to establish due dates and to calculate interest penalties, and (3) do not effect in any way the Government's right to reject goods or services after the 5-day period.

Second, we fully support Section 4(a)(1) in shortening the grace period to 7 days. However, we have some concern that eliminating all grace periods could increase administrative costs, further delay some payments, and pose risks of more early payments.

When the Prompt Payment Act was first considered by Congress vendors expressed concerns not over short payment delays, but over delays of 3 to 4 months or more. While 15 percent of payments occurred during the grace period, 60 percent of these payments were made within 5 days after the due date.

Mr. Chairman, this concludes my summary remarks. We stand ready to work with your Committee as you consider S. 328 and fully support the bill. We would be pleased to respond to any questions you or members of the committee have at this time.

Senator SASSER. Well, thank you, Mr. Steinhoff. There is a problem that we are all aware of which consists of late payments to private companies by the Federal Government. This bill seeks to address that problem of the Government not paying its bills on time. But there is a corresponding problem which occurs to me, and that is does the Government ever pay its bills sooner than it should, and if it pays them sooner than it should, does it receive any benefit from doing that? Just address yourself to that if you would.

Mr. STEINHOFF. Not considering progress payments, just normal payments due in 30 days, we found for a 4-month period that early payments cost the Federal Government about $120 million. Taken over a year, we are talking about between $300 and $350 million.

Senator SASSER. In early payments?

Mr. STEINHOFF. Early payments.

Senator SASSER. Now, when you say it costs the Federal Government, what do you mean?

Mr. STEINHOFF. To the extent the Federal Government disburses money early, it does not have use of those funds. So we are talking about an interest loss.

Senator SASSER. An interest loss if it had taken the money that it dispersed early and invested it——

Mr. STEINHOFF. Yes.

Senator SASSER [continuing]. During the period of time that it had the right to retain possession of it, it would have made $350 million in investments.

Mr. STEINHOFF. Presently, Senator Sasser, the Treasury Department has interest bearing accounts in which it invests its money.

Senator SASSER. Now, how much would the Government have been obligated to pay out in interest for late payments that it did not pay?

Mr. STEINHOFF. We estimated for a 1-year period approximately $38 million, of which we found, based on reports from OMB, approximately $7 million in interest had been paid. We found that out of six interest penalties that were due in our sample, only one was paid.

Senator SASSER. So what this bill would do, Mr. Steinhoff—and you correct me if I am wrong—this would set up a prescribed time table for the payment of bills that are sent to the Federal Government, and the Federal Government would save money by not paying its bills too early, if it adhered to the provisions of this legislation?

Mr. STEINHOFF. Yes.

Senator SASSER. It would also save money by not incurring an interest penalty by adhering to the provisions of this legislation?

Mr. STEINHOFF. Yes. And I think there are other ways that the Government can potentially save. Many of the problems are the result of poor systems, management systems that may be 20 years old. And to the extent that we can get those systems in better shape, we can reduce administrative costs, which will also save the Government money.

Senator SASSER. Can you give us an idea how much, if the Government conformed to the provisions of this legislation, over a year's time do you and your colleagues have a ballpark figure of how much money it would save the Government?

Mr. STEINHOFF. No, we do not. We could basically only talk about the interest that must be paid and the interest that is lost by paying early. So we are talking in the range of $300 or $350 million, less the interest penalties that would be due of roughly $40 million. But any other savings to the Government based on more efficient systems, based on better contractor prices, based on more people wanting to deal with the Government, we do not have any statistics on that.

Senator SASSER. Well, your statistics do indicate that the savings would be in the range of $400 million.

Mr. STEINHOFF. We are talking about an appreciable amount of money.

Senator SASSER. Right. I do not have any further questions.

Senator Trible?

Senator TRIBLE. I have no questions. Thank you, Mr. Chairman. Thank you for your testimony.

Senator SASSER. Senator Cohen?

Senator COHEN. One point. GAO indicated that roughly 25 percent of the Federal Government's commercial payments are late. OMB has a figure of 16 percent. Do you have any accounting for the difference?

Mr. STEINHOFF. Yes and no on that, Senator Cohen. Our study was done in 1986, and we took payments that were made in the latter part of 1985. We did a very comprehensive study visiting 39 payment centers. At that time, 25 percent in late payments was the experience that we found. We have not had an opportunity to examine the figures from OMB, which I believe came out today.

However, those figures are based on reports from the agencies themselves. To my knowledge, they are not based on audits or reviews, on exactly what went on at the payment centers.

Senator COHEN. Thank you.

Senator SASSER. Senator Pryor?

Senator PRYOR. No questions.

Senator SASSER. Mr. Steinhoff, one other question occurs to me. Under the provisions of this bill the Government, the acceptance begins to run, or is deemed to begin to run after 5 days. And this, in essence, shifts the burden to the Government with regard to making a determination expeditiously as to whether or not this bill should be paid.

In other words, the acceptance becomes automatic after 5 days. Now, what is the danger of the Government being pushed into the position of accepting shoddy goods or shoddy services, or is there a significant danger in the view of the General Accounting Office?

Mr. STEINHOFF. Mr. Chairman, I think the bill can be drafted so that it does not put the Government in a position of accepting faulty goods on services after 5 days, but states that for the purpose of computing the due date and calculating the interest owed, 5 days would be the acceptance period. If it takes an agency 10 days to accept, that would mean they would have 5 fewer days to actually pay the bill. But I think the bill can be written not to jeopardize the Government's ability to reject unsatisfactory or second-rate goods and services.

Senator SASSER. All right. Mr. Steinhoff, thank you very much, and I will have additional questions which I would want to submit to you for the record and would request an expeditious answer.[1]

Senator SASSER. Thank you very much.

Mr. STEINHOFF. Thank you, Senator Sasser.

Senator SASSER. Our next two witnesses consist of a panel. Mr. Michael Roush, the Assistant Director of Federal Governmental Relations for the National Federation of Independent Business, and Mr. Jack Rennie, the President of the Professional Services Council.

Gentlemen, we welcome you this morning before the Committee. And Mr. Roush, we will begin with you first and ask, if you can, to kindly limit your testimony to 5 to 7 minutes. Your entire statement will be included in the record.

TESTIMONY OF MICHAEL ROUSH, ASSISTANT DIRECTOR OF FEDERAL GOVERNMENTAL RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS[2]

Mr. ROUSH. Thank you, Mr. Chairman. Mr. Chairman and members of the committee. My name is Mike Roush. I am the Assistant Director of Federal Governmental Relations for the National Federation of Independent Business. NFIB is the largest organization in the country representing small independent business owners.

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[1] See p. 140.

[2] See p. 146 for Mr. Roush's prepared statement.

We have just over 500,000 members in all areas of commerce. We estimate that we have about 15,000 members whose sole or primary customer is the Government and to whom the issue of prompt payment of debts is of vital and direct concern. However, NFIB establishes its policy positions by polling its entire membership. And on the issue of whether the Government should pay late charges on overdue payments, they have voted 80 percent in favor of that, 18 percent against it, and 2 percent undecided.

However, the questions before the committee today are whether or not the law which now does require such late payments by the Government is working to speed up the Government payment process to its suppliers and whether it can be improved. Based on the comments and observations of our members, the answer to both questions is yes. That is, our members report considerable improvement in the speed of Government payments since the Prompt Pay Act of 1982 was enacted.

So we believe that the basic thrust of the legislation is being accomplished. However, we and they have observed spotty implementation by some agencies. We have discovered important omissions in the original Act, and we have complained that the Government has exploited to its fullest advantage unintended vaguenesses and loopholes in the 1982 law.

Because of these factors we believe strengthening and clarifying language needs to be put on the books. We therefore support S. 328, the Prompt Payment Act Amendments of 1987, and commend this Committee for its rapid attention to this issue.

Mr. Chairman, in order to help make the case that S. 328 is needed I would like to have permission to submit for the record three cases,[1] all from one company, all documenting three different aspects of the problem, and all having occurred within the last 9 months.

Senator **Sasser**. Without objection, the documents will be included in the record.

Mr. **Roush**. The cases are all of Ms. Rita Banks, the owner of Banks-Dorgan Co. of Norfolk, Virginia. The Banks-Dorgan Co.——

Senator **Trible**. You have my attention. [Laughter.]

Mr. **Roush**. She was going to be our witness today, as a matter of fact, but she is contesting some of these matters.

The Banks-Dorgan Co. supplies upholstery, draperies, slipcover fabrics and similar items, particularly to the Navy. One of the cases documents a situation where Ms. Banks was paid after 5 months and received no late payment interest at all. Another case documents a situation where Ms. Banks was paid late and not only did not receive a late payment, but the Government took and deducted an early payment discount from her final payment.

And the final case here is one where the Act worked, I guess, because Ms. Banks did receive her payment and her late payment interest, after 4 months, but only after an awful lot of detective work—which she documents—on her own part trying to track down her invoice through the Government paperwork maze. And then, even after she got paid, she was never sure she got the right amount of interest that was due, given the 4 months that the payment was late.

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[1] See p. 158.

And furthermore, she will never recover the interest that she has had to pay to her bank on loans that she has had to take out to cover her expenses while she was waiting for the Government to pay her. I did not include her bank statement, but she sent it to us.

I think Ms. Banks' case eloquently makes the case for much of the language in S. 328, and my written testimony contains other peoples cases which argue for at least the improvements contained in S. 328 as introduced.

Mr. Chairman, my final observation is of a late payment case and how it was handled during the reign of Kubla Khan. The case was witnessed and reported by Marco Polo. In reporting on the excellence of the Grand Khan's government and its administration, Polo witnessed a case where an administrator in charge of maintaining the roads of the kingdom failed to make a payment to a local townsman for his services. The Khan ordered that the administrator be taken into the street, beheaded and his body left in the dirt for the dogs to devour.

If we polled our members on that remedy, I am not sure how they would answer, but we do not ask for anything, obviously, so swift and so terrible, but we do ask that the Government live up to its obligations, and we think S. 328 will help it do so.

Thank you Mr. Chairman. I will try answer any questions you may have.

Senator Sasser. Thank you. We will turn now to Mr. Rennie.

TESTIMONY OF JOHN C. RENNIE, PRESIDENT, PROFESSIONAL SERVICES COUNCIL [1]

Mr. Rennie. Thank you, Mr. Chairman. My name is Jack Rennie and I am the President/Chief Executive Officer of a company called Pacer Systems with headquarters outside Boston but with offices in 5 or 6 States. We are now kind of getting to be a not so small Government contractor, acting both as a prime and subcontractor, delivering both services and hardware to the Government. So we have fulfilled a lot of the roles that are talked about in these discussions.

I am here today in several capacities. First, as President of Professional Services Council, an organization that is comprised of 6 trade organizations plus 80 independent professional services companies, and National Small Business United, a national organization with about 50,000 company members. And finally, in my role as Commissioner of Procurement of the 1986 White House Conference on Small Business.

These capacities allow me to view the impact of legislation and regulation having to do with procurement and the process very well, and provide me with extensive contact with Government contractors throughout the country. So it is with particular satisfaction I can come here today to fully support S. 328 and applaud the Committee for cosponsoring Senator Sasser's Prompt Payment Act Amendments of 1987.

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[1] See p. 175 for Mr. Rennie's prepared statement.

Speaking as a Chief Executive Officer—and this was mentioned earlier by yourself, Mr. Chairman—the importance of cash-flow cannot be overstated. It really is the life blood of any size company, especially small companies. The amount of working capital needed by a company is distinctly related to and can be computed by its cash cycle, the period between the time the cash has to be paid out and when the cash is brought in. And there are papers that can easily develop and show the sensitivity of extending that cash cycle on the requirements for working capital and cash in any company.

The Prompt Payment Act of 1982 we felt definitely was a major step forward. Certainly I, and all the organizations that I am involved with were involved in that effort to get it passed. But as perceived by this Committee and others, many difficulties still exist. And because cash is so vital, delayed payments by the Government directly threaten the health and even the life of some companies.

The record of compliance, while apparently generally good on paper, is in reality, I think, worse than it appears. Some parts of the Government simply are not complying, as is evidenced by the GAO report. Some may be technically complying, but they are playing games with the procedures in terms of when the clock starts and when it should have ended and when they paid.

And then you have the added what I can only call insults of taking early payments discounts after the stipulated period has finished and making companies chase interest penalties that they really should get automatically. The essential point made in different words earlier today in the hearing is that a company which delivers satisfactory goods and services to the Government deserves to be paid promptly, period.

In a market which is not a free-market system, but which is a monopsony, that is you have one customer, companies are especially vulnerable to the customer. It is outrageous that the customer takes advantage of this situation, stretching out companies which for the most part cannot fight back.

That is why the proposed legislative relief is so important. In addition to the specific provisions, I would note that it would help greatly to have the Government develop a uniform set of clear implementing procedures and incorporate these into the FAR, the Federal Acquisition Regulations.

Many aberrations in the payment procedures have been reported to me by professional services associations, the Professional Services Council, National Small Business United members, and during the White House Conference process, which as you know, Mr. Chairman, involved some 30,000 companies. And as the Commissioner on the Procurement section, I was the moderator on all of the regional meetings and the final White House Conference sessions on the procurement subject; and I heard of lost invoices, requisitions that are simply just kicked back for small technical reasons that really are not really legitimate, requirements to seek interest payments separately, et cetera.

I have a couple of examples in my own company that might be instructive. A couple of years ago when I was considerably smaller than I am now we had a case where the auditing agency in Boston, which is our principal payment office, moved from Boston out to a suburb, and in the process lost a $450,000 invoice from my company. That resulted in an additional 30 days loss of that money to my company. At the time it was a startling thing.

And just more recently in 1987—to show you how the dimensions of this can sometimes catch you unaware—just within the last month we had come to the point where we had $6 million of unpaid invoices. There was no question about their legitimacy and there was no question on whether the stuff received was acceptable or not. Six millions dollars.

Last year my company did $26 million in business, so this $6 million in cash that was out—we did not get paid anything from after the first of January until late in February from the Government—represents 25 percent of my revenues in 1986. I mean, just relative in size, that is a hell of a cash flow ripple, and only but the fact that my company is in pretty good shape financially, that cash ripple could have given us great headaches. And I have savvy people in my company that really know how to work the Government system probably as well as anyone.

Probably the most onerous problem seems to center on the time taken to accept the supplies and services. The typical invoice procedure of moving to a payment office, then to a contract technical rep, then to the DCAA, and finally to a payment center just simply takes too much time.

And that time does not even take into effect the time before invoicing where I have to pay people in advance, the classic first payment on a contract delay where everything seems slower, the inability to deal efficiently with contract modifications, which often can cause paper work to be turned back; and also, extensive distances, at times, between the various offices.

We have one company that I became familiar with where there initial submittal was into Philadelphia, the technical approval was in the Washington, DC, area, the DCAA that was referred to was in Texas, and the final payment center was in California. You can see what that kind of a chain with invoices moving around and so forth—I mean, it is just a great opportunity for things to get lost. And finally, there, of course, are the retainages, which are legitimate, but nevertheless they also come into the whole picture.

Other abuses we have seen or heard of include: Refusal to recognize automatic payment of interest; taking discounts after the terms have expired, as was mentioned; refusal to accept that the Prompt Payment Act applies to progress payments and cost reimbursement-type invoices, despite what we felt was a clarification by OMB.

The proposed amendments correct many of these deficiencies: Requirements for double interest penalties on late interest payments; the phase out of the 15-day grace period; flow-down provisions to subcontractors; stringent limitations on discount payments; and especially, the amendment dealing directly with the agency receipt process. We feel these are all very fine amendments, so in total, the Prompt Payment Act Amendments of 1987 provide, we feel, a potent improvement of the process.

Also, maybe as importantly, it signals the sensitivity of Congress to this important aspect of procurement and one would hope would stimulate greater sort of joining in on the part of the people in the system.

So that is why on behalf of the small business community and the members of NSBU and PSC I wholeheartedly endorse the bill. I believe that the proposed amendments will go a long way toward resolving problems not covered by the Prompt Payment Act and I applaud your continuing efforts.

We would be very pleased to have the opportunity to work with you to ensure passage of this legislation. Thank you, Mr. Chairman.

Senator SASSER. Thank you very much, Mr. Rennie, for your statement and your personal observations and experiences in doing business with the Government.

Mr. Roush, both in your statement and your written statement that has been submitted for the record and the statement that Mr. Pattie has just given us, you make mention of the so-called lost invoice situation. Could you give the Committee an example of how a payment center can exploit the lost invoice to avoid the payment of the late payment interest penalty?

Mr. ROUSH. I will not assert that the loss is an exploitation of the system. Some of the situations seems suspiciously like that. One of Ms. Banks' cases sort of seemed like it was somebody exploiting the system.

In one of its manifestations you can assert that it is lost and request a new invoice and start the clock all over again, and in other variations of it, as Ms. Banks experienced, you claim it is lost and somehow claim that that does not count in the clock running and that we found it and we are going to pay you, but she got no interest payment in that case. So there are different ways, I think, that that plays.

Senator SASSER. How do you advise your members to try to overcome the so-called lost invoice dodge? Do you have any advice for them on that subject?

Mr. ROUSH. Well, that is why I said if we polled that kind of a remedy I am not sure what the response would be. They might go for it. But often it is just as simple as to do business with somebody else. And that is what they are telling us, that they make that decision almost on their own, we cannot cope with this kind of paper chain and we cannot cope with this kind of lag. We cannot afford to borrow the money to pay our employers, to pay our taxes, and they just choose to do business with other people rather than the Government.

Short of that it is difficult. Like Ms. Banks, she has a person on her staff who does nothing but run these things down. That is her full-time job, to make the phone calls that are documented in there and get in her car and go over to the payment center and look in the face of the guy who is supposed to be making the decisions.

In fact, one of the things that is in my written testimony that I suggest might help people like Ms. Banks is that when they receive a notice of an incomplete or an improper invoice that a name or a telephone number of someone be put on it, as some do when regulations are put forward. A responsible individual is indicated, but that does not necessarily take care of the lost invoice case.

Senator SASSER. Let me ask you this, Mr. Roush. I am advised that the NFIB supports section 7 of this legislation, and I would just ask you the rationale whereby the National Federation of Independent Business supports section 7. How did you come to that support?

Mr. ROUSH. We are an organization that represents both kinds of parties in this situation.

Senator SASSER. I know, and that is the reason I am curious. I want to know how your organization resolved this whole question.

Mr. ROUSH. To us it is a matter of simple fairness, I think. The subcontractors are in the Government payment process. Most often the contractor serves a management function for the Government, using the subcontractors to accomplish the physical work. We do not see any reason why the prime contractor through who the payments have to funnel should be let off the hook if they in fact become the bottle neck in the payments.

In fact, we believe that the provisions of the Act should be extended to cover subcontractors of subcontractors, that not just construction contracts should be covered, but all contracts that involve subcontracting. We believe that the principles of the Prompt Pay Act apply across the board and that nobody should be left hanging at the end of the line over the Prompt Pay Act's coverage when involved in Government work.

Senator SASSER. Mr. Rennie, what position does your organization take on section 7?

Mr. RENNIE. They support it, Mr. Chairman. And we have discussed it. We have policy committees that get together and discuss the aspects of the bill. We do support it, and in fact, we also, basically, feel that flow-down provisions should apply to all subcontractors across the board involved with Government work.

As Senator Cohen indicated earlier, there are already plenty of precedents for this. When we are a prime contractor we are required to flow-down, for the most part, a large number of features of our contract, terms and conditions, et cetera, down to the subcontractors. This bothers us not at all. In fact, I think most of us try, in terms of the payment terms and so forth, to do that anyway.

But legislation, I think, would firm the whole thing up. And I do not feel it intrudes in the private contractual relationships to any extent. It really just gives the subcontractor something to rely on when dealing with the prime contractor. And the prime contractor has to step up and take the responsibility. He is being paid. He marks up everything that the subcontractors do, and the reason he is allowed to have the markup is because of value added to the Government, which is the management of the subcontractors. And part of the management is to ensure that he is getting the work done correctly.

Senator SASSER. Well, I find myself somewhat torn here. I hear the argument of the subcontractors, in which they say, well, if the prime is going to get paid on time, then we ought to get paid on time ourselves. And then I hear the argument, also, of the general contractors, and I am somewhat sympathetic with that, in which they say, well now, we ought to have a law making the Government pay its own bills on time, but the Government ought not to get involved here in a private contract between the contractors and the subcontractors, that is a matter between these two private contracting parties.

How do you answer the general contractors' argument on that?

Mr. RENNIE. Well, I think that it is just a matter that is already done all the time. It seems to me the Government somewhere in the past has recognized a responsibility and felt it was in its best interest to flow-down certain provisions of the prime contract. I just feel that this is another one in that category. I do not think it is anything that is greatly disturbing. We have to do it, and when we are a subcontractor, we expect to have the flow-down provisions.

Senator SASSER. Mr. Roush, how about the National Federation of Independent Business?

Mr. ROUSH. Much the same kind of consideration. I did check to see what kinds of precedents, what kinds of other contractual flow-downs are in Government contracts now. This one, in this bill, strikes me as a minimal. I mean, it only talks about commonly accepted industry practice and a payment clause to achieve that.

It does not dictate the terms of that clause, nor does it leave the contractor liable in any way. I mean, I have reviewed some of the arguments that the Associated General Contractors have put forward, and frankly, as a non-lawyer but having checked with some lawyers, I do not find any of them persuasive or substantive.

The concern I had when I read the legislation initially was that perhaps the real concern was general contractors were going to find themselves in a situation where the Government did not pay them on time but they were required to pay their subcontractors within a specified time. But having checked and gone over the language, that is not the case. It is a case of pay when paid, I believe is the phrase.

Senator SASSER. Well, Thank you, Mr. Roush.

Senator Trible.

Senator TRIBLE. Mr. Chairman, I will not ask detailed questions of these witnesses but I do want to thank Mr. Roush and Mr. Rennie for their testimony today and for speaking not only in behalf of themselves but for a much larger constituency. The importance of your testimony is that you speak from experience in the real world. And you have detailed, I think, many of the problems that still exist, that plague the lives of business people large and small, the kind of problems that demand our response. Mr. Roush, you tell Ms. Banks that we have heard and that we are going to respond.

Mr. ROUSH. Thank you, Senator. Thank you, Mr. Chairman.

Senator SASSER. Gentlemen, thank you very much. We appreciate you appearing here and giving us the benefit of your views today. It has been very helpful.

Our next panel will consist of three individuals, Mr. Paul Emerick of Emerick Construction Co., Portland OR, who will be representing the Associated General Contractors of America; Mr. M.R. Sullivan, Jr., Sullivan Mechanical Co., representing the American Subcontractors Association; and Mr. David Buttrum of the Swanson-Nunn Electric Co., representing the Associated Specialty Contractors.

Gentlemen, I have a hunch that you are not going to be in total agreement today before this committee. Mr. Emerick, we will start out and let you have the opening salvo today. We want to welcome all of you before the Committee and say that we look forward to receiving your testimony and I am confident that it will be very helpful to us in our final deliberations.

TESTIMONY OF PAUL EMERICK, EMERICK CONSTRUCTION CO., PORTLAND, OR, REPRESENTING THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA [1]

Mr. **Emerick**. Thank you, Mr. Chairman. I am Paul Emerick, Vice President of the Associated General Contractors of America, and as the vice president of the association certainly appreciate this opportunity to present the reasoning for our vigorous opposition to section 7, and only section 7, of S. 328, the Prompt Payment Act Amendments, which would federally mandate payment terms in private subcontracts on Federal construction projects.

I listened with considerable interest to the concerns and the indicated remedial intent of the bill as espoused by Chairman Glenn, by yourself Senator Sasser, and Senator Trible this afternoon. And I can state here and now categorically that AGC wholeheartedly supports everything that was said by those three gentlemen today.

As a matter of fact, it is this Prompt Payment Bill, irrespective of section 7, that in and of itself is a most effective means of ensuring prompt payment to the subcontractors, sub-subcontractors, and suppliers.

I also would like to respond to the committee's letter dated February 26 to AGC which erroneously contends AGC is strongly opposed, quote: "* * * to any similar coverage of timely payments between prime contractors and their subcontractors under Federal construction contracts."

AGC does not oppose prompt payment to subcontractors under Federal construction contracts, or any other contract. In fact, AGC publishes and promotes the use of a subcontract form for Federal construction work that unequivocally requires payment to subcontractor no later than 7 days following the general contractor's receipt of payment from the owner, and in this case, the Government.

What AGC does oppose is first, a Government intrusion into the business terms of the private subcontract relationship between the Government's prime contractor and its subcontractor. Secondly, imposing new risks and liabilities upon the general contractor without corresponding control.

AGC finds such intrusion particularly burdensome and onerous when an industry itself has already agreed prompt payment to subcontractors follows prompt payment to the general contractor. Proponents of section 7 would have it have mandatory subcontract payment term is a matter of simple equity. That is, if the prompt payment is good for the general contractor, it certainly ought to be good for the subcontractor. And I think that is very true. That is right.

However, after careful analysis of section 7, one realizes that such an analogy is dangerously flawed. I have been a general contractor for over 30 years and I am here to tell this committee that successfully managing subcontract performance on construction projects is no accident.

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[1] See p. 185 for Mr. Emerick's prepared statement.

It is a learned skill with a high degree of risk. A single national payment term, however vaguely defined, is too inflexible. Not all subcontractors are alike. In fact, the one single common denominator is their extraordinary responsiveness to the subcontract terms of payment.

Subcontractors vary by size, by trade, by performance capabilities, capacity, credit rating, expertise, local market practices, and a whole myriad of other things. In the aggregate, however, we must group subcontractors into two categories. First, the subcontractors who provide the general contractor with performance and payment bonds. Second, those who do not.

As a general contractor, I must treat those two groups entirely differently. Those who do provide bonds are entitled to the same terms of payment—I repeat, the same terms of payment—from me as the general contractor as I as the contractor receive from the Government.

For those who do not provide the same security bonds I must have the freedom to employ all of the requisite and traditional procedures and techniques and business judgment at my disposal to ensure my ability to successfully complete the contract, and that necessarily includes terms of payment.

Section 7 makes no distinction between these two critical categories. One might expect section 7 would require a payment provision that affords a general contractor the same security from the subcontractor as the Government receives from the general contractor. But it does not.

The Government owner can afford to make full payment to the general contractor because it has the security of legally required performance and payment bonds that guarantee the project will be completed and that the subcontractors and the sub-subcontractors and suppliers will be paid.

As proposed, section 7 inherently increases the general contractors risk for subcontractor payment and performance by denying the general contractor the traditional private subcontract administratively tools to protect himself.

With your permission I would like to read three quick notices I just received today. First, and I quote: "Based on our understanding of section 7, it would place new and uncontrollable risks and liabilities on a general contractor relative to his ability to control subcontractors' performance and assure subcontractor payments to sub-subcontractors.

"These new uncontrollable risks and liabilities will effect a Surety's ability to bond a general contractor on Federal construction work. At a very minimum Congress has, in my view, an obligation to consider the impact of section 7 on the Surety and Bonding industry. We too are at great risk. Our Agency, Thomas McGee and Sons has been in the industry since 1910 and has continually provided bonds and surety to the construction industry," signed, Larry Kominsky, Partner.

The second one: "Although this Association has no official position with respect to the captioned legislation, I am writing to express my views as to the impact on contractors of section 7 of the captioned legislation. While it is true that I am unable to speak from the vantage point of a surety company, I am of the opinion that the provisions of section 7 of this bill would certainly cause surety underwriters to pause and perhaps reconsider providing surety bonds to general or prime contractors should they be subjected to the provisions of section 7 of the bill.

"Should the bill become law, further, it is my belief that because of the possible surety bonding complications that could or would come about as a result of section 7, inclusion of that section, at least as drafted at present, should be carefully reconsidered and hopefully moderated," signed Bruce T. Wallace, National Association of Surety Bond Producers.

A third, and quickly: "USF&G, United States Fidelity and Guarantee, is one of the largest writers of performance and payment bonds for the construction contractors on Federal projects. Based on our understanding of the provisions of section 7 of the Amendments to the Prompt Payment Act, the requirements that subcontracts should be paid in full at the completion of their portion of work, my project would materially increase the risk and exposure of the prime contractor in the event of problems arising later when the entire project is near completion.

"This exposure and risk would also increase the Surety's concern, and could lead to restriction in the bond credit available to the prime contractors. For this reason USF&G supports your efforts in objection to the bill," signed, John H. Huss, Vice President, USF&G.

I was pleased that Mr. Pattie noted that there should be a correction to the information that they submitted prior to this time in that ABC and ACEC, neither have taken positions supporting section 7.

Proponents of section 7 have offered no credible evidence of the problem section 7 is alleged to solve. You will search the record in vain if you are looking for any objective evidence of prevalent subcontract payment problems when the general contractor received prompt payment from the Government.

Furthermore, there is a dearth of evidence that the real party in interest, the Government contracting agencies, would support the extension of Federal administrative involvement into subcontract payment terms. On the contrary, Federal procurement officials steadfastly refuse to be drawn into subcontract administration issues.

In fact, the Office of Management and Budget opposes section 7. It is simply naive to suggest that the Federal intrusion into the heart of a private subcontract payment can be imposed without creating both practical and legal complications that will impair the efficient delivery of construction for the Government owner.

To assert that section 7 is self-enforcing is to deny the full complexity of the construction process. Section 7 would embroil the Government contracting officer in subcontract disputes.

If objective evidence of subcontract payment problems under Federal construction contracts were available, AGC would ask this Committee to first inquire whether prompt payment to the general contractor would have cured the problem.

It contradicts all logic to take the unwarranted step of Federally mandating subcontract payment clause without first exploring this simple little remedy that is already available in the proposed Act.

That is, prompt payment by the Federal Government to the general contractor. Remember, the subcontractor's payment follows payment to the general contractor by the Government.

AGC also asks this Committee to recognize the numerous standard subcontract remedies already existing to protect subcontractors. Proponents of section 7 make the assertion that mandatory payment terms are no intrusion into the private business judgment, or if so, they are somehow legitimated by other federally mandated flow-down clauses.

The act currently declares how the Government will conduct its business on its contracts. The act will not support Federal regulation down through the entire stream of commercial, incidental to Federal prime contracts.

A fair appraisal of the existing mandatory flow-down clauses reveals Federal procurement policy only implements broad national, social, civil rights, and environmental policies, not congressional concern for the narrow and specific interests of such a subcontractor.

We note that some proponents of section 7 have cited an imbalance in bargaining power between the subcontract parties as a rationale for new Federal regulation. That is absolute nonsense. Again, we must reiterate that subcontractors and general contractors come in all sizes.

We are not talking about an international conglomerate versus a one-man subcontractor. We are talking about two typical members of the industry, both of which are members of the small business community, negotiating the final steps of a subcontract.

If you have got any doubts about the ability of the subcontractor to so negotiate, I would call your attention to a book written by a subcontractor organization, distributed to its entire membership, which devotes itself exclusively on how to negotiate and revise subcontracts.

Subcontractors are properly free to pick and choose their projects and the general contractors that they might wish to work for or do business with. The Senate should not allow itself to be so easily moved as to accept the myth that an imbalance in bargaining exists.

In conclusion, AGC submits that the record thus far is devoid of the necessary evidence to warrant congressional action. Surely proponents of such a radical change in well-established Federal policy must meet a much more stringent burden than they have thus far for moving congressional action, a very serious step.

Furthermore, if equity is really what the proponents of section 7 are seeking—and I repeat—if equity is really what they are seeking, then the subcontractor, to enjoy the privilege of Section 7 payments, must be conditioned upon that subcontractor providing the general contractor with a bond, both payment and performance.

Or conversely or alternatively, the Government must indemnify the general contractor from claims by the Government for omissions or deficiencies in the subcontractor's work which are detected following the Government's mandated payment.

If section 7 provided either of these alternatives, then the subcontractor would be to the general contractor as the general contractor is to the Government or the owner, and then and only then, gentlemen, would equity be achieved. Thank you.

Senator SASSER. Thank you very much, Mr. Emerick. Before we get to questions we will move on and hear from Mr. Sullivan.

TESTIMONY OF M.R. SULLIVAN, JR., SULLIVAN MECHANICAL CONTRACTORS, INC., REPRESENTING THE AMERICAN SUBCONTRACTORS ASSOCIATION [1]

Mr. SULLIVAN. Thank you, Senator. I had the opportunity in mid-February to meet with some of your constituents in Nashville at which time I presented a video of your presentation of the Prompt Pay Act of 1987. They, as do I, applaud the efforts of you as well as the distinguished Senator from Virginia, and Mr. Levin. We thank you for your work in bringing this bill forward.

My name is Mac Sullivan. I am executive vice president of Sullivan Mechanical Contractors, a family-owned company in Shenandoah, VA. Today I am representing the American Subcontractors Association.

ASA strongly supports S. 328, particularly section 7, the payment clause for subcontracts under construction contracts. We believe that section 7 would end late pay to subcontractors from prime contractors who routinely pay late in order to gain a competitive edge or to increase their profits.

Subcontractors depend on the cash-flow generated by progress payments to meet their payrolls and loan payments and to pay their suppliers. Yet, some prime contractors take 60, 90, or more days after being paid by the Government to pay their subcontractors.

Let me demonstrate what that kind of delay means to a typical subcontractor on a typical job. Let's take for example a $500,000 mechanical subcontract scheduled to take 5 months to complete. If you will allow me to simplify it just a little bit, let's assume that the work will be divided evenly over the duration of the project.

So during the first month the subcontractor spends $100,000 on supplies an labor. In the construction industry most suppliers demand to be paid in advance. And remember, Federal law requires that we pay our workers weekly.

The subcontractor will requisition for March's work about March 25th. The prime contractor then combines his many subcontractor's payment requests into an itemized application for payment with the necessary supporting data. If the general contractor is a good manager he will submit his application of payment to the Government around April 1st and the Government will consider it received about the 5th.

The Government's 30-day payment clock runs out about May 4th. In the meantime, the subcontractor has paid out a second $100,000 and has not yet received a penny for his efforts, but the general contractor is paid for the month of March.

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[1] See p. 264 for Mr. Sullivan's prepared statement.

If the Government required prompt pay for subcontractors, as do 15 States, the subcontractor would be paid by May 11, 73 days after his first cash outlay, and 48 days after he submitted his request for payment.

Instead, the odds are he will not get paid during April, and in the meantime he has paid out another $100,000. If he is working for a good general contractor, the subcontractor may only have to wait another 30 days, until June 4th, to be paid for March.

So if our subcontractor is lucky, he will only pay out $300,000 before he receives his first payment of $100,000. But on many projects he will pay out the $400,000 and even the $500,000 before he receives his first progress payment.

For a big business such a delay in payment may cause some concern in the bookkeeping department, but business would go on as usual. For a small firm the size of most construction subcontractors, however, one payment might mean the difference between survival and disaster.

To better demonstrate the impact slow payment has on a typical subcontractor, we have reviewed the letters that ASA National has received during the last 6 months and compiled the most pertinent remarks, including several cash flow statements, in a summary that we would like to submit for the record.[1] The magnitude of the slow-pay problem can be still better understood when you recognize that on Federal building projects subcontractors provide as much as 80 percent of the on-site labor and materials. Yet ASA has been and remains concerned about the confusion and misunderstanding that surround the subcontractor provisions.

Section 7 merely requires that a prime contractor on a Federal construction project include a payment clause in its subcontract agreements which meet two basic requirements; first, the payment provision must conform with prevailing industry standards.

Second, as an enforcement mechanism, the agreement between a prime contractor and a subcontractor must entitle the subcontractor to a late payment interest penalty at the same rate applicable between the prime contractor and the Government.

That is all section 7 does. It does not impair the Government's ability to award a single contract. It does not constitute an unprecedented or unwarranted intrusion into a private contractual relationship. It does present a means for drawing the contracting officer into disputes between a prime and its subs. It does not impair the general contractor's ability to require payment and performance bonds from his subcontractors, and it does not duplicate existing remedies available to subcontractors to obtain payment.

Other than the minimum standards I described, the parties to the subcontract are free to negotiate the other terms of their payment clause. The point of section 7 is quite simple. If full payment has not been earned by a subcontractor because of poor performance, he should not be paid.

By the same token, the prime contractor should not bill the Government and collect payment for the subcontractor's work. The Government, not the prime contractor, should be holding all unearned payments until they have been earned. The Federal Government has every right to be concerned that subcontractors are paid on time.

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[1] See p. 319 for copy of "Subcontractors Talk about Slow Pay on Federal Construction."

Prompt payment assures a good working relationship among all parties on the construction job. The Government may suffer from delays, poor workmanship, and increased costs if this relationship breaks down. Competition will also be limited as subcontractors become more and more reluctant to bid on Federal jobs because of poorer and poorer payment practices.

Mr. Chairman, I thank you and the other members of the committee for this opportunity to present ASA's case on prompt pay for subcontractors. We have a much more detailed written statement that we ask be incorporated in the formal record of this hearing. Thank you.

Senator **SASSER**. Without objection it will be incorporated into the hearing record in its entirety.

We will turn now to Mr. Buttrum, representing the Associated Specialty Contractors.

TESTIMONY OF DAVID A. BUTTRUM, SWANSON-NUNN ELECTRIC COMPANY, REPRESENTING THE ASSOCIATED SPECIALTY CONTRACTORS, INC.[1]

Mr. **BUTTRUM**. Thank you, Mr. Chairman, Members of the Committee. My name is David Buttrum. I am Vice President of Construction for Swanson-Nunn Electric Company in Evansville, Indiana. It is a family owned and operated business. We specialize in heavy construction and industrial work.

I have personally managed Swanson-Nunn Electric Co.'s extensive effort as a subcontractor of Corps of Engineer work. I am here today on behalf of the Associated Specialty Contractors, an umbrella organization representing the interest of over 165,000 specialty construction contracting firms.

I speak to urge your support for all the proposed revisions of the Prompt Payment Act, including and especially Section 7 dealing with flow-through of prompt pay benefits to subcontractors.

The problem of subcontractors not getting paid on time on Federal work is widespread. My written testimony thoroughly describes what can happen to a subcontractor and in fact did happen to Swanson-Nunn Electric Co. To boil it down, there is simply no way a subcontractor currently can enforce the payment terms of his subcontract on the prime contractor in a timely fashion.

Most every standard construction subcontract has a payment clause which says that the subcontractor is to be paid within 3 to 7 days after the prime contractor has received payment for the subs work.

Senator **SASSER**. Would you repeat that, Mr. Buttrum. I did not catch that.

Mr. **BUTTRUM**. Yes, sir. Most every standard construction subcontract has a payment clause which says the subcontractor is to be paid within 3 to 7 days after the prime contractor has received payment for the sub's work. However, the only way to enforce payment on a Federal job is through a Miller Act lawsuit, which takes years and deep financial resources to pursue and then attorney's fees eat up any recovery.

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[1] See p. 371 for Mr. Buttrum's prepared statement.

Progress payments are made to a prime contractor by the Government on the basis of their certified pay requests, which is determined from subcontractor invoices and the percentage of completed work already accomplished. The prime contractor merely brokers money actually due subcontractors when he receives payment from the Government.

If he refuses or delays payment to the subcontractor, the subcontractor has no way to make him pay. The prime contractor has already certified the progress of the subcontractor. He has been paid by the Government for this certified work.

Does he now contend this certification of progress is fraudulent? Is he going to return the overpaid funds to the Government? I think not.

We need help. It is difficult for me to remain calm an unemotional when I discuss AGC's "privity of contract" issue and their objections to the prompt payment requirements for subcontractors. We, the subcontractors, have been on the short end of the stick for so long I get angry when I see this concentrated effort to keep us there.

Here are some points that need to be mentioned concerning this privity of contract issue. First, please remember that we are discussing public work. The Government has a right and an obligation to see that the money is spent wisely, fairly, and that the money paid for subcontractors' work is passed on to the subcontractors on a timely basis.

Second, nearly 50 clauses are required by current Federal law to be passed through to the subcontractor on a Government project. I have with me today some examples of pass-through clauses required of me by prime contractors on Federal projects which I would like to have included in the hearing record as supplementary documentation.

One more clause is not going to make any difference and it certainly will not destroy the prime/subcontractor relationship.

Third, the money belongs to the subcontractor. Currently there is no way to force the prime to pay the subcontractor, short of a lawsuit. And that is just not fair or equitable. A prime contractor actually profits by delaying payments owed to the subcontractors. If you take away the profit the payments will be made.

Fourth, the law of the land says that a prime contractor has an obligation, in spite of continuing efforts of the Associated General Contractors to limit it, to pay his subcontractors for work performed and material installed by their subs. This measure will not change the law. It only adds a time limit to comply with the law and an interest penalty to ensure that the payment obligation is met.

Fifth, most prime contractors already acknowledge the implicit relationship between a subcontractor and the Government by including a pay when paid provision in a subcontract. Such a clause merely reinforces our contention of the roll of the prime as merely a payment broker.

Finally, delayed payment by a prime contractor to subcontractors after receiving payment from the Federal Government for that subcontractor's effort is purely a form of blackmail and I, for one, am tired of it.

Attached to my written testimony is a legal opinion from the firm of Kasimer & Ittig showing that the "privity of contract" issue has no basis in the law as applied to this legislative proposal. It is nothing more than a smokescreen for greedy prime contractors.

Good prime contractors, who are fair and honest, will not feel any effect as the result of this additional section 7's language. If the section 7 language is retained bad prime contractors will no longer be able to scavenge on funds due their subcontractors. They will no longer be able to play the cash flow games with subcontractors' money. I strongly urge you to continue to support the entirety of S. 328, including section 7 language.

Thank you for allowing me the opportunity to testify.

Senator **Sasser**. Thank you, Mr. Buttrum. I see that you are not ambivalent about the provisions in section 7. [Laughter.]

Mr. **Buttrum**. I certainly am not.

Senator **Sasser**. Before turning to my colleagues here, Mr. Emerick, you are representing today the Associated General Contractors, and included in your organization, as I understand it, are a substantial number of subcontractors. That was brought to my attention by some correspondence I received from a contractor in my State of Tennessee who indicates that he is both a general contractor on some occasions, a subcontractor on others, and a member of the Association of General Contractors.

But as I understand it, the Associated General Contractors is composed of about 32,000 members. About 8,400 of them are general contractors, and you have perhaps about 7,000 subcontractors in the Associated General Contractors.

Is there unanimity among these subcontractors that comprise a substantial portion of the membership of AGC with regard to section 7 of this legislation? Or near unanimity? You will never get unanimity among 7,000 individuals, but near unanimity.

Mr. **Emerick**. I appreciate your latter comment. I am aware that there have been one or two comments, one or two contractors' comments in opposition to our position. That is rather insignificant compared to the numbers you just gave us.

Senator **Sasser**. Has there been an effort made to poll the membership of your organization, to your knowledge, that would determine the views of the subcontractors in your membership, or for that matter, of the general contractors?

Mr. **Emerick**. We have not made a formal poll. However, we just completed a convention, here in Washington, by the way, 2 weeks ago—maybe a week ago, I kind of lost time—and this was certainly a subject of keen interest at that convention. Again, there was not opposition at that convention. And we had 5,000 members in attendance.

Senator **Sasser**. Well, I asked that question because so many members of your association, I gather, wear two hats; one, as a general contractor, and the other as subcontractor, if the information that I am receiving is correct.

There is one other question that I wanted to address to you——

Mr. **Emerick**. If I may, I would comment on that statement, Mr. Chairman.

Senator **Sasser**. Yes, sir, please do so.

Mr. **Emerick**. We consider that to be very important that we are composed of both and that the subcontract form I alluded to in my presentation has been very carefully drafted so that we can use the same document whether we be the general contractor in a particular project, or a subcontractor in a particular project. We believe the terms for one are good for the terms of the other.

Senator **Sasser**. Now, Mr. Emerick, I first developed my interest in the Prompt Payments Bill while serving on the Small Business Committee here in the Senate on which I still serve. And our Chairman there, Senator Bumpers, received a letter from the Executive Director of the Associated General Contractors in which he called the payment provision in section 7 risky payment terms.

Now, you indicated, I think, that prime contractors are generally making payments to their subs now within 7 days of receipt of payment from the Government. If that is correct, why would the Executive Director refer to section 7, which generally calls for the same thing, as risky payment terms? What would be risky about that?

Mr. **Emerick**. I would like to take maybe a minute or two——

Senator **Sasser**. Please do. We want to let everybody have a full airing of their views here and we are trying to use this hearing to learn as much as we can about the various arguments that are being advanced.

Mr. **Emerick**. I will not ask for equal time with all of my opponents, but I would like to take a few moments on this particular issue. There is a myth that is permeating this whole subject. AGC is not opposed to prompt payment, one. Two, AGC has a subcontract that they promote that says 7 days after we get paid.

Three, our objection to section 7 of S. 328 is because of two things; one, and we have already heard so much about the intrusion into the private business matters of a contract relationship between the subcontractor and the contractor, and the 28 flow-down causes that we have heard so much about, both in written testimony and here today.

We contend all fall within three categories. They are social-economic, they are civil rights, or they are environmental. Broad-based things. Not anyway near that which would be for a single self-serving interest group.

Secondly, and this is extremely important, the way section 7 is drafted—I would like to give you a couple of examples to make the point. A general contractor would be required to pay the subcontractor in full on completion of a subcontractor's portion of the work, under section 7. Let's say it is a 2-year project and the subcontractor's work was completed during the first 6 months of the project.

In accordance with section 7, the subcontractor was paid in full, and then sometime within the remaining 18 months of the project an omission or deficiency is detected by the Government or the work that they had asked us to pay by mandatory flow-down clause, and the subcontractors have been paid.

Now, the Government decides that I have got to protect myself on this problem. So they, on my next progress billing, withhold funds in the bottom of the billing that I have submitted. The subcontractor is all done, he is all paid. Section 7 does not say that subcontractors provide me with a bond, like I do for you, that gives me the protection in case that subcontractor is no longer capable financially of withstanding his obligation at that time. And that is a real problem.

So that it is the fact that section 7 places a burden upon us, a liability upon us, and takes away from us the ability to control. They do not give us the security to go along with it, the offset. That is the key. And that is why we suggested to you that we either need to have a bond from the subcontractor in order to allow him the same privileges—and our subcontract, by the way, says exactly that—or the Government indemnifies us from coming after us for what they said they now do not like that they once said we should pay for.

Senator **Sasser**. Well, Mr. Buttrum and Mr. Sullivan, how do you respond to that? In other words, what happens here if you have a general contractor who receives payment from the Government and he promptly pays the sub, in conformance with the statute, within 7 days, and then he gets down the line about 30, 45, or 60 days and the Government inspector comes in and says, you have shoddy work here, tells the prime contractor, and says the government is going to withhold funds on him until you, the subcontractor, get this repaired.

And maybe the sub is not financially able at that time to come back and redo it, or maybe the general contractor says, I do not want him to do it. How do we respond to that apprehension on the part of the general contractor? What would you say about that?

Mr. **Buttrum**. Well, number 1 is I do not believe that section 7 has anything to do with that. Section 7 merely says that if the prime contractor has been paid, that he has an obligation to pay the sub. Now, there are all sorts of contractual language in a subcontract between a prime and a subcontractor that says that the sub is responsible for guaranteeing the work.

That obligation has not been eliminated.

In Swanson-Nunn's case—and if you look in my written testimony there are pages and pages—we did work for the Department of Energy under a prime contractor that had $265,000 of our money on a $500,000 job for over a year simply because he had spent the money someplace else.

I had no way—Swanson-Nunn had no way—to get the money from him other than a Miller Act lawsuit. And I had payment provisions in my contract with him that said I would be paid within 10 days or you will pay me interest. There is no way to enforce it.

Now, I disagree with the AGC saying that it is intruding into that relationship. We have not stricken any other contract language. We have only put a time limit on when they will pay the money.

Senator **Sasser**. One final question, my time is about gone. Do you want to respond to that, Mr. Sullivan?

Mr. **Sullivan**. In today's atmosphere, under the Prompt Payment Law of 1982 a prime contractor has four basic modes of security on a subcontractor. One, he has the obligation to inspect the work to ensure that it does meet the standards.

No. 2, he has the opportunity to withhold retainage from a subcontractor. No. 3, he has the opportunity to require a performance and payment bond. And 4, he can require retainage and a performance and payment bond.

Under the new law when it is passed he will have the same right—obligation—to inspect the work. He will have the right to withhold retainage. He will have the right to bond's and for retainage and bonds. The only difference is that when he submits his requisition and a $100,000 requisition that he received from a subcontractor, less the retainage, he will only bill for the amount that he is going to pay the subcontractor—$100,000, 10 percent retained, he bills for $90,000 he pays $90,000. He still has a 10 percent protection factor down the road if there are problems with the work.

Senator **Sasser**. Thank you, Gentlemen.

Senator Trible?

Senator **Trible**. Thank you, Mr. Chairman. This obviously is the stickiest part of this bill. Everyone applauds the provisions of this bill, but there is some dispute about section 7. And it is difficult when you have friends on both sides of an issue, as all of us do here.

I think we learn more by listening to you than listening to ourselves. To that end, I would invite you to respond to the points that have been made by the other. Your statements kind of passed like ships in the night.

And Mr. Emerick, the key point that you made was that section 7 will impose new risks without giving you adequate control over performance. And you went on to say that you must be able to exercise some influence over the terms of payment to ensure that a job is done satisfactorily. That seems to make a lot of sense, and that was what brought about the question posed by the chairman.

And Mr. Buttrum and Mr. Sullivan, on first blush, at least, have responded rather satisfactorily to that concern. Would you like a second crack at that?

Mr. **Emerick**. I sure would.

Senator **Trible**. All right, sir. I expected that you might. Just take my time, Gentlemen, and use it. I think we will do well if you all will go to it, and at this time of the day it might keep us all alive and kicking.

Mr. **Emerick**. It is my interpretation of section 7 that whatever the Government pays me on behalf of the subcontractor I am obligated to pay him, irrespective of what my subcontract might say in any other way. Whatever the Government pays me on behalf of the subcontractor I am obligated to pay him, No. 1.

No. 2, if the Government holds retainage on me on behalf of that subcontractor I may withhold that retainage on the subcontractor. The Federal law does not require the Government to withhold retainage on me and me on the subcontractor. Only that if the contracting officer deems at some point in time there is unsatisfactory work, so I do not have the right, as is implied by the counter statement here, to hold retainage, other than what the Government holds from me.

No. 3, it was stated that I still have the privilege of requiring a bond. That is correct. But if I do that, that is a permissive response to the mandatory requirement of the direct payment, flow-down now.

If I get the money, I pay the subcontractor, mandatory. My only way of protecting myself, I believe, is either the Government by the same token says, Mr. Subcontractor, if you want that privilege of payment in that manner, give that general contractor the same security that I made that general contractor give me, the Government, and which in return I gave him those privileges in terms of payment, tit for tat.

Or, the Government says to me, I no longer will hold you responsible for a deficiency in that subcontractor's work which I have already told you you must pay him. They need to indemnify me for that, one way or the other.

I hope I responded directly to your question.

Senator **Trible**. Mr. Sullivan?

Mr. **Sullivan**. I disagree. If we take a $500,000 subcontract and we put 10 percent on it on behalf of the general, and he did not, in his negotiations with me, require a retainage—he required retainage of 10 percent for me to get the job—he did not ask for a bond, he got the retainage. As it stands today, he would bill to the Government, on five equal payments, $110,000 a month, out of which, because we have the agreement in the contract of 10 percent, he would pay me $90,000.

At the end of the 5-month period I would have been paid $450,000, he would have been paid $550,000. That is the way it works today. If you look at it under the new law, I would bill $100,000 less 10 percent retainage, or $90,000, in accordance with our contract that we have together.

He would then put his markup on the $90,000 and submit that to the Government. The Government would pay him and he would get his $10,000 plus the $90,000 he is paying me, or $100,000. At the end of the job he would have received $500,000.

He would have paid me $450,000, and the Government would still be holding $50,000 because he did not feel that he was secure in stating that the work was installed in accordance with the plans and specifications and the standards and he had his security. Now, that is the way I interpret it.

Mr. **Emerick**. We obviously need a clarification as to what that really says, because we do not agree on what it says.

Senator **Sasser**. Mr. Buttrum.

Mr. **Buttrum**. We are talking about invoices that have been submitted to the general contractor, or the prime, however you want to say it. They use—to the contracting officer when they submit those invoices—they send in backup, and the backup is the subcontractor's invoice.

The contracting officer at that point pays the general contractor—the prime contractor—money allocated to those backup invoices. It is the sub's money. OK. The prime contractor has an obligation to pay for the sub's work. After the job is done—you know, the AGC's argument just does not hold water—after the job is done and everybody has been paid and there is some deficiency, the AGC still has a contract with the sub that says you have a year's warranty.

It has not changed. All we are saying is, AGC, you get paid for subcontractor's work, you have an obligation and now a time constraint that says that you will pay the sub.

Mr. **Emerick**. Give me a bond to guarantee that warranty and we start talking.

Senator **Trible**. May I ask one more question, Mr. Chairman?

Senator **Sasser**. Yes, you may.

Senator **Trible**. Mr. Sullivan, I think you indicated in your testimony that 15 States have prompt payment requirements for subcontractors?

Mr. **Sullivan**. Yes, sir.

Senator **Trible**. Now, what is the relationship between contractors and subcontractors in those States?

Mr. **Sullivan**. There is a pass-through in 15 States with prompt pay to subcontractors. The number of states that have prompt pay is much higher than that. It is in the 40's. I do not know exactly, but 15 have prompt pay with pass-through to subcontractors.

Senator **Trible**. But there is an experience in at least 15 states through which we can measure the viability of the pass-through provisions?

Mr. **Sullivan**. Yes, sir.

Senator **Trible**. And Mr. Emerick, no doubt your colleagues are active in those states as well?

Mr. **Emerick**. I submit in order for that statement to be valid you need to very carefully check the 15 quote, unquote, "prompt payment" requirement statewide against the proposed section 7. I submit they are not the same.

Senator **Trible**. Well, we will do that, and I thank you for your spirited testimony today, gentlemen. We will benefit from what you have brought to our attention.

Thank you, Mr. Chairman.

Senator **Sasser**. Thank you. Senator Levin, would you like to enter this fray here?

Senator **Levin**. Not particularly. [Laughter.]

Senator **Sasser**. Maybe you could shed a little light on this whole matter. I do not know who the contractor was who put in these microphones here but——

Senator **Levin**. We had better say contractor or subcontractor.

Senator **Sasser**. That is right.

Mr. **Emerick**. Thank you, sir.

Senator **Levin**. First, Mr. Chairman, I have an opening statement for the record.

Senator **Sasser**. Senator Levin's opening statement will be included as a part of the record.

[Senator Levin's opening statement follows:]

Opening Statement of Senator Levin

Mr. Chairman, I am pleased that our committee is holding these hearings today. The bill that is before the committee, the Prompt Payment Act Amendments of 1987, is a much needed measure to ensure that our government will live up to its obligation to pay its bills on time. Many businesses—especially small businesses—

simply cannot afford the financial difficulties caused by the Government's failure to pay the money to which they are entitled.

The bill-paying practices of the Federal Government have improved over the five years since the Prompt Pay Act was enacted in 1982. However, some Government agencies continue to exploit loopholes in the act. This bill is designed to prevent such practices by clarifying the date on which payments become due, making the payment of interest automatic, and phasing out a 15-day grace period that has been abused by some Government agencies.

Mr. Chairman, the bill now before this committee—S. 328—is identical to a bill that was endorsed by this committee and the full Senate in the last Congress. It is my hope that this year the bill will become law.

I look forward to the testimony of the distinguished witnesses at today's hearing.

Senator LEVIN. Let me commend our chairman and Senator Sasser for the leadership that they have taken on the Prompt Pay Act. I am delighted to be a cosponsor of their effort. I wish that they did not get into such complicated areas as section 7 but it comes with the territory and we have to find a way to solve that equitably as well.

In the meantime their leadership has been instrumental in at least getting the Federal Government to get to the verge of doing what we ought to do with four prime contractors. Going beyond that is what section 7 is all about.

I have a couple of questions for you, Mr. Emerick. Your bottom-line point, it seems to me, is that if we are going to force you to pay promptly we have got to protect you by forcing the subs to put up bonds so that you are protected adequately.

My question is, why not do that by private contract? If section 7 were adopted why would not the general contractors, the prime contractors, just automatically insist on a bond being in the contracts that they have with the subs?

Mr. EMERICK. Mr. Senator, I am sorry to say that I have to say I believe if we insisted on the subcontracting industry providing bonds for each project they work on—each general contractor on Federal work—you would have to eliminate at least 8 of the 10 subcontractors now proposing bids for that work.

They are not able to provide those bonds. We are at tremendous risk, and that is what I am trying to get across here today.

Senator LEVIN. You are saying that you would lose a lot of potential competitors, people who compete for your contracts, is what you are saying?

Mr. EMERICK. I am saying the Government would lose the advantage of that competition.

Senator LEVIN. Well, both would presumably lose the advantage.

Mr. EMERICK. Correct.

Senator LEVIN. Do we have any statistics at all in the area of prompt pay to subcontractors, anyone who knows about what the average length of time is for payment to subs? We know what the statistics are but we know it for prime. Has anyone done any statistical work on——

Mr. BUTTRUM. I do not have any statistics for industry wide but I can tell you what it is for the company I work for.

Senator LEVIN. No. I am talking about industry wide at this point. Do you know of any, Mr. Emerick?

Mr. EMERICK. No. But I would like to draw a guesstimated analogy for you. There are some 400,000 contractors in the United States. Let's be very conservative. Let's assume that the average contractor only has two projects going and each billing for that project only involves 10 subcontractors.

Now it is common for there to be 20 to 40 subcontracts on a project. But let's assume it is only 10. Now, 2 times 10 is 20 times 400,000 means that there are 8 million payment requests per month throughout this country. Now, we have got to talk about a whole lot of big problems before there is any relativity to it.

Senator **Levin**. Well, my question is has anyone done any statistical survey to find out what the average pay period is between primes and subs. I know there are 8 million transactions a month—or I will take your figure, whatever it is—but there are 240 million Americans and we take scientific surveys of them all the time. Can we not take a survey, or has there not been the desire on anybody's part to tell us what the extent of this problem is in a more scientific way?

I mean, usually before Government intervenes in an area like this we know the extent of the problem. This is a relatively new area, at least in one sense. There are pass-through provisions of contract provisions with primes, but most of them do have to do with certain social requirements involving the environment or involving a number of other things where we have an interest, a very distinct social interest to make sure that that is passed along.

And even more important, that clause would never be the subject of a contract revision or negotiation between a sub and the prime but for our requirement that there be a pass-through provision. Here the pay period can and usually is a subject of a negotiation, or it readily could be between the sub and the prime.

So my question is, why no statistics?

Mr. **Emerick**. My answer has to be, sir, I do not know of any such survey.

Senator **Levin**. OK.

Mr. **Emerick**. But I have a suggestion, if I may.

Senator **Levin**. Will it take a long time?

Mr. **Emerick**. No. GAO made a very serious study of prompt pay. I would suggest that one of the things that might be done here to consider this overall issue, including this bonding problem, is that you set section 7 aside, go ahead with the rest of the bill.

Everybody agrees with the rest of the bill that has been here. Set section 7 aside and ask GAO to make such a study so you have valid statistics. And if that produces that sort of information as being alleged here, of consequence, then we can look at the bonding issue, we can look at the alternatives we have offered to you, and come up with a sound answer.

Senator **Levin**. OK. Thank you, Mr. Chairman.

Senator **Sasser**. Mr. Sullivan.

Mr. **Sullivan**. Senator Levin, ASA conducted a survey early last year prior to the hearings that were held last year on this bill, and the results of that survey were—the No. 1 priority of subcontractors was the concern about getting paid on time. It was also reflected in the White House Conference that it was a high ranking item at that time.

Senator **Levin**. I think Mr. Emerick's suggestion was that they do a survey. If that survey could be done in a matter of months, assuming they have access to this data, do you have any objection, anybody at the table?

Mr. **Sullivan**. It would be hard to do a survey of Government agencies about subcontractors getting paid on time because we——

Senator **Levin**. Oh, no. A survey of contractors and subcontractors.

Mr. **Sullivan**. We have no relationship with the contract management.

Senator **Levin**. Well, the privity is not stopping you in urging section 7, so I am sure you would give them access.

Mr. **Sullivan**. Sure.

Senator **Levin**. Would you give them access?

Mr. **Emerick**. Absolutely.

Senator **Levin**. Okay. So, assuming they have access, and everyone seems to be open to that idea, you would not have any other problem with that, would you?

Mr. **Sullivan**. No.

Senator **Levin**. I have a question for you two Gentlemen at that end of the table. Do I have another minute or two?

Senator **Sasser**. Yes, another minute or two, Senator Levin. Take as long as you want. We have got all afternoon. It is only 4:25. [Laughter.]

Senator **Levin**. I do not know whether I am getting us in deeper or trying to get us out here.

How would the subs react to a suggestion that we not only protect you with section 7 but that we protect your suppliers?

Mr. **Sullivan**. No problem.

Senator **Levin**. And if we go down this road that we say that you would be required by law in any contract covered by this act to promptly pay your supplier.

Mr. **Sullivan**. We would have no problem with that.

Senator **Levin**. You would support that?

Mr. **Sullivan**. Last year, Senator, we actually suggested that.

Senator **Levin**. I am done in one minute instead of two. You owe me a minute, Mr. Chairman.

Senator **Sasser**. Thank you very much, Senator Levin.

Gentlemen, thank you very much for appearing here today and giving us the benefit of your views. This is a troubling section for us, trying to determine where the equities really lie, where the problems really are.

I, for one, may have some additional questions which I would like to submit to you for the record, and would ask for an expeditious response. We will be studying this issue here of section 7 very closely.

Senator Sasser. Thank you very much for giving us your views on this subject today.

Mr. **Emerick**. Mr. Chairman, may I respectfully ask that the three communications I just read to you that I just received could be incorporated in the record. We will submit the originals here today.[1]

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[1] See p. 220.

Senator SASSER. Oh, yes, indeed. They will be made a part of the record.

Mr. Sullivan, those are not real greenbacks there are they? [Laughter.]

Senator SASSER. Gentlemen, thank you. Our next witnesses are Mr. Joseph Wright, the Deputy Director of OMB, the Office of Management and Budget, and Mr. Frank Swain, the Chief Counsel for Advocacy from the Small Business Administration.

Gentlemen, we welcome you here before the committee and will ask you, in view of the lateness of the hour to adhere as strictly as possible to our admonition to limit yourself to 5 to 7 minutes in your opening statements.

We will go first with Mr. Wright from OMB. They control the purse strings so we ought to give them some preference here. Mr. Wright?

TESTIMONY OF JOSEPH R. WRIGHT, JR., DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET

Mr. WRIGHT. Thank you, Mr. Chairman. Following your suggestion on the lateness of the hour I would like to submit my testimony for the record [1] and just add a few brief points if I may.

Senator SASSER. Yes, you may.

Mr. WRIGHT. I think that you will see in my testimony, and also I believe in the GAO report and comments here, that there has been some progress since 1981 and in 1982 when the Prompt Payment Act was enacted.

In 1981, 30 percent of the payments were late, 45 percent were early. In 1986, based on the information that the agencies have given us, 84 percent were on time. Of those that were late, 13.5 percent were in the grace period, so that means that basically we are down to a couple of percentage points, and that is much better performance.

This is not the level of performance we should have, but it is much better performance.

Senator SASSER. Now, what did you say the performance was prior to the passage of the original Prompt Payment Act?

Mr. WRIGHT. In 1981, 30 percent of the payments were late and 45 percent were paid early.

Senator SASSER. Forty-five percent were paid early or paid on time?

Mr. WRIGHT. Paid early.

Senator SASSER. All right.

Mr. WRIGHT. Now, we have made progress, but I would like to assure the Chairman that it is not easy in implementing this Act, first, because many of the agencies had a free rein for many years in terms of their payment practices, as you can see from those numbers, both and made payments early and late.

And secondly, agencies for the most part send a request to Treasury to pay and there is no trigger on the payments. Treasury simply cuts the checks on a first-come, first-served basis as the agency sends them in. Finally, there was not a lot of incentive for agencies to pay right on time. The Prompt Payment Act changed that.

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[1] See p. 424.

Now, I would like to give the Committee some good news, and that is that, for the most part, we do support this legislation. We think it is important legislation and we think it is good legislation and it makes sense and it is the way we should be running the Government, more like a business.

We do take exception to the double interest penalties, for which we see no reason because we think the process problem should be resolved first, rather than just doubling the penalties.

We also object to the position that has been discussed in the recent hour, and that is the subcontractor clause. In this one we think the Government will be getting into fairly dangerous ground without a good reason at this stage, because as Sen. Levin and Mr. Emerick just mentioned, we have not seen any statistics that show that there is a problem.

Now, we will actually be moving to implement the intent and many of the provisions of this legislation as soon as possible. First, on the grace period, the grace period should be reduced from 15 days to 7 by the end of fiscal year 1987.

We also agree with reducing it from 7 days to zero, but we would like to tell the committee that we will try to do it one year earlier than the deadline in the proposed legislation. We think we can make it at the end of fiscal year 1989 rather than 1990.

On the revision of the Federal Acquisition Regulation, we sent out a proposed rule yesterday, Mr. Chairman, for a 60-day notice comment. Whenever the legislation passes we will be more than happy again to submit a proposed revision to the FAR. Instead of the 120 days that is proposed, we think we can make it within 90 days.

On the revision to our circular A–125, we are ready to go whenever you are, Mr. Chairman. We will be more than happy to send it out right after the bill is enacted. If, the Committee thinks that it may take longer to get the legislation passed, we are ready to go next month with the revision.

We are asking the agencies right now to send corrective action plans to address whatever weaknesses they have including those that led to making the 29,000 payments recorded as late and without interest penalties. We will ask them to implement those plans by September 1.

To support these activities we are going to ask the Inspector General to do reviews if agency reports under A-125 to make sure that all of those corrections were done by October 1st. The IGs will also review agencies, under OMB circular A-123, which governs the internal control process. Their findings will be reported in their semiannual reports to the Congress, and it in the President's annual management report, for which this Committee has the primary oversight responsibility.

I would say in closing that, we think that the Prompt Payment Act is good legislation. I would suggest that while it is good legislation for contractors, I think it would also be good legislation to expand into other areas of payments.

You have $164 billion that are covered by the Prompt Payment Act right now. Another $240.7 billion at the end of fiscal year 1986 was not covered. That includes $59.5 billion for financing progress payments. That includes $73.8 billion for Medicare payments to hospitals. And that includes $107.4 billion for grants-in-aid to State and local Governments.

We think, Mr. Chairman, that the Committee should seriously take a look at expanding the principles of the Prompt Payment Act into these extremely important areas. I do not see why a hospital that is receiving a payment from the Government for services rendered should be treated differently from a contractor that is providing services or products, whether it be for defense, nondefense, or whatever.

I would also say the same thing of State and local Governments. Not only do we in general support the legislation with those two minor disagreements—evidently one is not too minor—but we would like to see it expanded into those three large areas that represented almost $241 billion in spending last year.

Thank you Mr. Chairman. I would be happy to answer whatever questions you may have.

Senator SASSER. OK. Mr. Swain, we will hear from you now.

TESTIMONY OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION

Mr. SWAIN. Thank you very much, Mr. Chairman. It is a pleasure to appear before you and this Committee on this legislation. The Committee has our statement for the record[1] and I would ask that it be received and rather than go over it verbatim, bring out a few key points, most of which have already been brought out by all the other witnesses.

There is very little new to say, and so I will not take up the Committee's time, except to reiterate that it is important legislation to small business. I attended at least 25 to 30 of the State White House Conferences, as well as the Federal White House Conference, the National Conference here in August last year.

The issue of prompt payment has moved along considerably since the 1982 law, but many potential contractors felt that it had further to go. We are particularly pleased at several initiatives that have been taken within the executive branch to try to fully implement this act. And I might point out as Mr. Wright alluded to that since our statement was in fact submitted to the Committee two days ago, there was a notice published in the Federal Register yesterday that would make by regulation some of the changes that are called for in the statute.

I mention that to indicate that I think the Administration is doing its best to enforce good-faith progress among the agencies, but I think it would be very helpful if several of these changes were statutorily legitimized.

Our statement endorses all the points. I should say the statement does not touch on either the issue of interest-on-interest or subcontractors. I will state for the committee that in reviewing the provision on interest-on-interest I must say that I am not sure that there is, in fact, a need for that in the legislation if we clean up the other loopholes, as the legislation proposes.

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[1] See p. 434.

And on the subcontractor issue, I am inclined to agree with Mr. Wright, from a philosophical standpoint, that we should be very wary about getting the U.S. Federal Government involved in a process where we may be potentially regulating some conduct downstream.

By the same token, I was at 25 or 30 of these meetings and I heard a lot of complaints by subcontractors and I think there is some legitimacy to their complaints. It seems to me that despite the somewhat elucidating statements of the previous witnesses, as Senator Trible said, some of their statements were like ships passing in the night. And listening to that entire discussion, I still have a lot of questions about what exactly the nub of the problem is and how the proposal in this particular legislation might work.

I am saying as a practical matter I would certainly volunteer that our office could get copies of those 15 State statutes that have been alluded to, try to figure out if there is a common theme, and what the record has been. I am not sure though that we are in a position to say as a practical matter that the subcontractor provision that has been written in the bill is the best provision at this point, even if one philosophically were in favor of it.[1]

Senator **Sasser**. OK, Mr. Swain, thank you.

Mr. Wright, let me just ask you some questions here. Now, OMB has been taken to task for their attitude towards the Prompt Payment Act of 1982 for not moving expeditiously to try to see that that act was complied with, in fact, OMB has been criticized in some quarters for virtually abrogating the Prompt Payment Act.

Let me give you an example. The proposed Federal Acquisitions Regulations that were published for comment in the Federal Register by OMB on July 17, 1986, set out the guidelines whereby under the proposed regulations agencies would have a minimum of 75 days to make payment before a contractor would be entitled to any late payment interest penalty.

Now, that is not indicative to me that OMB really has its heart in trying to enforce this Prompt Payment Act. I notice the complete revision was developed and published for a second round of comment just yesterday, May 18, 1987. I wonder if that was done in anticipation of this hearing here today?

Mr. **Wright**. Well, Mr. Chairman, the timing of the hearing certainly did not help. [Laughter.]

I think it was a good idea to publish that one way or the other, whether it came out next week or whether it came out next month. But it is very clear that a 75 day payment period is too long.

You know that many of the procurement agencies look upon the changes to the FAR as something that is rather painful to them. They will change a bit of the process that the agencies have right now.

Everybody thinks that everybody responds to OMB very rapidly. And it is a little bit tougher to do that in the regulatory process. As I said, the FAR was issued yesterday in anticipation of this hearing. Without the hearing it probably would have been another couple of weeks before the FAR would have come out. I did not see any reason to come up here and testify before you without it being published when I could and get it speeded up.

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[1] See p. 449 for subsequent letter to Chairman Glenn from Mr. Swain regarding Section 7.

Senator SASSER. Well, I think it is well that we both agree that this other proposed regulation that they have a minimum of 75 days to make payment before the contractor would be entitled to a late payment interest penalty virtually emasculates the whole reason and rationale and philosophy behind the Prompt Payment Act.

Now, we heard testimony here from the National Federation of Independent Business, and they referred to a Ms. Banks in Virginia that apparently employees someone full time to try to corral the Federal agencies into paying the invoices that she sends them.

And one of the ways to handle this, it has been suggested, would be the establishment of a Prompt Payment Hotline. Now, OMB promised to do that back on June 19, 1986 and reiterated that promise, I am told, on July 29, 1986 in testimony before the House Government Operations Committee.

Has that Prompt Payment Hotline been instituted yet?

Mr. WRIGHT. It has not, Mr. Chairman.

Senator SASSER. Well now, we need to get on with that, Mr. Wright, because that is one way that these small business people can call in and get some prompt action.

I have found, and I suspect that you would agree with this viewpoint, that the Federal Government, like most large bureaucracies, responds many times to some sort of stimuli. And I think a hotline whereby someone could call and get an ombudsman to work on getting their bill paid I think would be a very good thing to do.

We spend a lot of our time here in the Senate and an enormous amount of my staff time is delegated to getting the Federal bureaucracy to do what it ought to do in the first place. And so I would urge you to move just as expeditiously as you can and get that Prompt Payment Hotline put in. Maybe if we would call another hearing here in a couple of weeks you might get that hotline in the day before the hearing and you could come up here and tell us that that thing is operating full blast. [Laughter.]

Mr. WRIGHT. Mr. Chairman, may I respond to that?

Senator SASSER. Yes, you certainly may. We do not cut anybody off here.

Mr. WRIGHT. All right. After the hearings last year we did go back and take a good hard look at that hotline with the help of the President's Council on Integrity and Efficiency [PCIE]. I am Chairman of this group which is the President's Council of the Inspectors General.

The PCIE felt very strongly that a hotline was not appropriate in this particular case and would actually duplicate the hotlines that they have within their agencies and would go circumvent the proven, workable, and effective mechanism for recording complaints not only within the agencies, but from outside of the agencies.

Now, it seems that whenever a problem appears the reaction is to establish a hotline. And while that can give you some good information, in certain isolated cases, I am not so sure is this case that it would be any better than the existing Inspector General's hotlines. Much more important a great deal of pressure from the Office of Management and Budget on the agencies to get the systems in place so that the payments are made on time.

I believe with followup by the Inspectors General, as I described earlier, to make sure that the data that is provided to us is correct and then putting the process in place to make sure the payments are made and corrections are made where they are not is the right way to go.

So this was taken to the Inspector Generals. They are a very savvy group. They know how this Government operates. They are not part of the bureaucracy at all, and they recommend strongly against it.

Senator SASSER. Well, I would remind you that it was the OMB witnesses themselves that told the Government Operations Committee over in the House of Representatives on July 29 that they were going to put a hotline in. And they thought it was a good idea at that time. And who is going to go over there and tell Chairman Jack Brooks that you are not going to put that hotline in? [Laughter.]

Mr. WRIGHT. Well, Mr. Chairman, as usual that will probably be my chance to excel. [Laughter.]

But in this, as in many cases, the Office of Management and Budget is humble and practical enough to listen to good advice all around us. And in this case we did listen to people who are responsible for correcting problems within the Government bureaucracy, and respect their recommendations. And so that is the reason why we decided not to put it in.

Senator SASSER. Well, I suppose my reaction to that would be, if those Inspector Generals were doing such a hot-rock job with their hotlines over there we would not be here today trying to redo this Prompt Payments Bill to try to compel the various agencies to actually pay their bills promptly and pay them on time.

And I must say to you I think there is nothing quite as bracing to most Federal agencies as to get a call from the Office of Management and Budget asking them why they have not done thus and so. I think it is sort of like—what do they say? Nothing like a hanging to sharpen your mind. Well, I think that sharpens the mind and concentrates that thoughts of most bureaucrats when they get a call from OMB.

And I am still very much in favor of that hotline and I think the burden of proof is going to fall very heavily on OMB to convince me and others why we should not go forward with that.

A couple of other questions. Mr. Wright, how about expanding on your views on Medicare and the Prompt Payment Act. You alluded to that in your statement, as I recall, and I would like to hear your comments about that, because I am getting constant complaints from health care providers in my State about the failure of the Medicare system to compensate them on time.

Mr. WRIGHT. All right. I would be happy to, Mr. Chairman. I would like to put it in the context though, also, of the three large areas that I mentioned that I would like the committee to consider expanding the Prompt Payment Act.

The context includes the financing or progress payments, the grants-in-aid to State and local Governments, and also Medicare payments. In Medicare, the payments in 1986, as I mentioned, totaled $73.8 billion. The payment schedule for Medicare during this year is to pay what they call "clean claims" Those that can be paid right away, within 30 days of receipt, and to allow Medicare contractors to pay claims faster, if possible, within their operating budgets.

This policy would result in a national average claims payment time about the same as in 1986. That is not 30 days, that is 20 days. In fact, in the first months of this fiscal year the average payment time was even faster than the 20 days. I believe it was around 17 days.

HHS has notified the Congress that they are going to try to control the payment of claims so that they maintain a 20-day average. It is my interpretation that the Congress put a 30-day payment time for this year.

The Budget Reconciliation Act of 1986 required Medicare to go to a 26-day standard in fiscal year 1988, down from 30. In other words, speeding up the payment cycle.

We have sent up a proposal to try and hold it to the 30-day cycle, just like other contractors. As I said, we are beating that rate now. At the present time, data from Medicare indicates we that over 95 percent of all the clean claims are paid within the 30 days. The average, though, is less than 20 days.

This is not a small amount of money, Mr. Chairman. Savings, on just the proposal to hold it at 30 days next year instead of the 26 days mandated by OBRA, would amount to almost $900 million next year.

Again, when you hear from the contractors, I understand their point of view. They have a cash-flow problem just like everybody else. But the average on this is less than 20 days, so they are getting preferential treatment compared to almost everybody else that is being paid by the Federal Government.

Senator SASSER. Now, Mr. Wright, I understand that OMB has a problem with the double interest provision of this bill. Yet, I do not know of any better way to force or compel a Federal agency to pay its bills on time than if they do not pay them on time they are going to have to pay interest. And then if they try to get around paying the interest when they do not pay their bills on time, they have got to pay double interest.

Because here is what I envision happening. A bill coming into an agency, it is laying around there, and finally it is eligible, or the agency is liable to pay the interest payment, the late payment to the contractor. The person who has the responsibility for paying the bill says, well, I will go ahead and pay it and I will not pay the interest and I will put the burden on the contractor to try to collect that. He probably will not, and anyway, I want to cover myself with my supervisor. If he starts looking at this and he sees that I have paid interest on it, then I am going to be in trouble with him for not paying this bill on time.

So they will try to slough it off. And in 90 percent of the cases, or 95 percent, my guess is they would be successful. Now, that same person who has the responsibility for paying that bill in the agency, if he or she knows that if they do not pay the interest payment when the bill is late—if they try to slough it off and try to get by without paying interest—they may be subject to a double interest payment later. Then, they have got two explanations to make to their supervisor: 1, why they did not pay the bill on time; and No. 2, since they did not pay it on time, why did they not include the interest payment due.

And by their double negligence of not paying the bill on time and including the first interest payment, now they have made the agency doubly liable for interest.

Now, it looks to me like that ought to be the hammer that just might make the bureaucracy respond and pay interest when required. Now, what is OMB's problem with that?

Mr. WRIGHT. Mr. Chairman, that could work the way you are talking about but I doubt it. I do not think it would make much difference. I really do not.

I do not think the double penatly would straighten out a severe process problem, if an agency has one. I doubt very seriously whether or not it would result in anybody getting fired or demoted.

Senator SASSER. Well, when your auditors started going back through that agency would somebody start demanding an explanation about why the agency could not pay required interest, why are they having to make double interest payments? I would expect somebody would be called to accounting for that eventually.

Mr. WRIGHT. We are going to be doing that with the single interest.

Senator SASSER. If they are not there is something wrong with our oversight procedures.

Mr. WRIGHT. I agree with you, but we are going to be doing that with the single penalty. And on the schedule that I read to you——

Senator SASSER. But you see my point is this, with the single penalty they will try to slough it off on the contractor. And if they are late paying the bill, which we see is many times—I forget what the precise statistics are—1 out of 6, or 5 out of 6 times they are late paying the bill, they will not pay the late interest charge that is due.

And so your auditors will not pick that up.

Mr. WRIGHT. I think the agencies will respond, Mr. Chairman, for two reasons: First of all, they will have the opportunity to come up here and explain to you why these payments are being made late. Believe me, that has much more of an impact on somebody within the executive branch, in my opinion, than any interest penalty, whether a double interest penalty or over a triple interest penalty. We have a severe process problem that must be resolved. That is the way to get to the crux of this.

I have no problem with the single interest penalty. That does serve as an incentive, but it will not correct the severe process problem.

Now, one of the reasons why we are going to ask the Inspectors General to review agency performance under A-125 and A-123 is because we are trying to use the bureaucracy and the check on the bureaucracy with a forced reporting through the semiannual reports to the Congress to make sure that follow-up occurs.

That is the way that you are going to get these problems resolved. I do not think you are going to do it by just doubling the penalty.

Senator **Sasser**. Well, I am not sure I agree with you on that, Mr. Wright, but I am going to let you have the word on that temporarily. But we are going to have the last word on the bill, because I think we are going to put that double interest provision in it.

Gentlemen, I thank you for appearing here this evening and giving us the benefit of your views. I think this has been a most helpful hearing. I think all sides must conclude today that their views have got a complete and full airing, and we are going to try to move expeditiously on this legislation.

I think it is high time that the business community of the country can rely on the fact that the Federal Government will pay its bills in a timely fashion, and this legislation, I think, will go a long ways to making sure that that becomes a reality.

Thank you all. This Committee is in recess.

[Whereupon, at 4:55 p.m., the Committee adjourned subject to the call of the Chair.]

100TH CONGRESS
1ST SESSION

S. 328

To amend chapter 39 of title 31, United States Code, to require the Federal Government to pay interest on overdue payments, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JANUARY 20, 1987

Mr. SASSER (for himself, Mr. TRIBLE, Mr. GLENN, Mr. ROTH, Mr. CHILES, Mr. DANFORTH, Mr. BUMPERS, Mr. WEICKER, Mr. COHEN, Mr. LEVIN, Mr. MOYNIHAN, Mr. D'AMATO, Mr. NUNN, Mr. ZORINSKY, Mr. BAUCUS, Mr. RUDMAN, Mr. DIXON, Mr. BOREN, Mr. KASTEN, Mr. KERRY, Mr. SANFORD, Mr. NICKLES, Mr. HARKIN, Mr. GRASSLEY, Ms. MIKULSKI, Mr. STEVENS, Mr. BINGAMAN, Mr. PRYOR, Mr. GARN, Mr. MITCHELL, Mr. FOWLER, Mr. GORE, Mr. STENNIS, Mr. HECHT, Mr. HOLLINGS, Mr. HEINZ, Mr. HEFLIN, Mr. WALLOP, Mr. HUMPHREY, Mr. LEAHY, Mr. STAFFORD, Mr. ADAMS, Mr. LUGAR, Mr. PELL, Mr. PACKWOOD, Mr. BURDICK, Mr. DURENBERGER, Mr. DODD, Mr. MELCHER, Mr. DECONCINI, Mr. BOND, Mr. RIEGLE, Mr. SYMMS, Mr. MATSUNAGA, Mr. QUAYLE, Mr. PRESSLER, and Mr. FORD) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

A BILL

To amend chapter 39 of title 31, United States Code, to require the Federal Government to pay interest on overdue payments, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Prompt Payment Act Amendments of 1987".

CONGRESSIONAL FINDINGS

SEC. 2. The Congress finds that—

(1) the billpaying practices of most Federal Government agencies generally have improved, with certain exceptions, after four years of experience under the Prompt Payment Act (codified in chapter 39 of title 31, United States Code):

(2) the improvement in such billpaying practices has resulted in fairer treatment of contractors who furnish supplies, services, or construction to the Federal Government, especially small businesses;

(3) nonetheless, many contractors who deal with the Federal Government continue to experience persistent problems of untimely Government payments as a result of—

(A) the failure to implement the provisions of the Prompt Payment Act through the Government-wide Federal Acquisition Regulation;

(B) the implementation of the provisions of the Prompt Payment Act in a manner that denies the Act's protections in cases of certain contract payments, such as progress payments for work satisfactorily performed under construction contracts and payment of amounts which have been retained by a Federal Government agency during the performance of construction contracts and are to be released upon final acceptance of the construction work by the agency;

(C) the unlimited time presently afforded Federal Government agencies formally to accept supplies delivered or services performed by contractors, which may be improperly used by such agencies to deny late payment interest penalties to contractors delivering such supplies or performing such services in a timely manner as prescribed by the contract;

(D) the implementation of the provisions of such Act in a manner which has permitted Federal Government agencies to take discounts for early payment months after the expiration of the discount period specified in the contractor's invoice;

(E) the failure of the Act explicitly to require Federal Government agencies automatically to pay late payment interest penalties due to contractors;

(F) the absence of incentives effectively to dissuade Government employees from attempting to withhold late payment interest penalties which contractors are entitled to receive;

(G) the continued availability of certain payment grace periods which affords Federal Government agencies the opportunity to pay their bills late without incurring any late payment interest penalty and, thus, unilaterally to extend the payment due date upon which the contractors have based their contract prices;

(H) the failure of Federal Government agencies to implement the requirement in the Act to pay, during the contract period, for the periodic delivery of supplies or the periodic performance of services if permitted by the contract; and

(I) the failure of the Act explicitly to protect contractors doing business with the United States Postal Service;

(4) the Federal Government will realize substantial benefits if Government construction contracts require Government contractors to pay their subcontractors and suppliers in a timely manner, in accordance with prevailing industry standards, or be subject to the same late payment interest penalties prescribed in the Act; and

(5) a strengthening of the provisions of the Prompt Payment Act, and its vigorous enforcement, is a key recommendation made to the President and the Congress by the delegates to the 1986 White House Conference on Small Business.

DEFINITIONS AND APPLICATION

SEC. 3. (a) Section 3901(a)(4) of title 31, United States Code, is amended to read as follows:

"(4) the head of the agency is deemed to receive an invoice on the later of—

"(A) the date on which the office or employee of the agency designated by the agency to first receive such invoice actually receives a proper invoice; or

"(B) on the fifth day after the date on which, in accordance with the terms and conditions of the contract, the property is actually delivered or final performance of the services is actually completed, as the case may be, unless the contract specifies a longer period for agency acceptance of the property or services.".

(b)(1) Section 3901 of such title is further amended by adding at the end the following new subsection (c):

"(c) This chapter, except section 3906 of this title, applied to the United States Postal Service. However, the Postmaster General shall be responsible for issuing the implementing procurement regulations, solicitation provisions, and contract clauses.".

(2) Section 410(b) of title 39, United States Code, is amended by inserting after clause (8) the following new clause (9):

"(9) Chapter 39 of title 31.".

INTEREST PENALTIES: REDUCTIONS IN GRACE PERIOD; INCREASED PENALTIES

SEC. 4. (a)(1) Section 3902(b) of title 31, United States Code, is amended—

(A) by striking out "16th" in clause (3) in such sentence and inserting in lieu thereof "8th"; and

(B) by adding at the end the following new sentence:

"Clause (3) of the preceding sentence shall not apply to payments under any contract for which the procurement solicitation is issued on or after October 1, 1990.".

(b) Section 3902 of such title is further amended by redesignating subsections (c) through (e) as subsections (d) through (f), respectively, and by inserting after subsection (b) the following new subsection (c):

"(c)(1) Any amount of an interest penalty which exceeds $1.00 and is owed a business concern under this section shall be paid without regard to whether the business concern has requested payment of such penalty.

"(2) If a business concern—

"(A) is owed an interest penalty by an agency;

"(B) is not paid the interest penalty in a payment made to the business concern by the agency on or after the date on which the interest penalty becomes due;

"(C) is not paid the interest penalty by the agency within 10 days after the date on which such payment is made; and

"(D) makes a written demand, not later than 40 days after the date on which such payment is made, that the agency pay such a penalty,

such business concern shall be entitled to receive an interest penalty equal to twice the amount of the interest payment that would otherwise be due.".

INTEREST PENALTIES ON PROGRESS PAYMENTS AND RETAINED AMOUNTS UNDER CONSTRUCTION CONTRACTS

SEC. 5. Section 3903 of title 31, United States Code, is amended—

(1) by striking out clause (4);

(2) by redesignating clause (5) as (6); and

(3) by inserting after clause (3) the following new clause (4):

"(4) in the case of a construction contract, provide for the payment of interest on—

"(A) any progress payment due under the contract for—

"(i) a period of more than 7 days; or

"(ii) a longer period if the contracting officer determines that the prevailing practice in private construction contracts is to provide such longer payment period; and

"(B) any amount which has been retained during the performance of the contract and are due to be released to the contractor after final acceptance of the construction, if such retained amount is not paid to the contractor by the required payment date;".

PERIODIC PAYMENTS UNDER SUPPLY AND SERVICE CONTRACTS

SEC. 6. Section 3903 of title 31, United States Code, as amended by section 5, is further amended by inserting after clause (4) the following:

"(5) provide for periodic payments, in the case of a supply or service contract which authorizes periodic payments and periodic submission of invoices during the contract period, upon—

"(A) submission of an invoice for supplies delivered or services performed during the contract period; and

"(B) either—

"(i) acceptance of the supplies or services by an employee of an agency authorized to accept the supplies or services; or "(ii) certification, by such an employee, that the performance covered by the invoice conforms to the terms and conditions of the contract.".

PAYMENT CLAUSE FOR SUBCONTRACTS UNDER CONSTRUCTION CONTRACTS

SEC. 7. (a) Chapter 39 of title 31, United States Code, is amended—

(1) by redesignating sections 3905 and 3906 as 3906 and 3907, respectively; and

(2) by adding at the end the following new section 3905:

"§ 3905. Payment clause for subcontracts under construction contracts

"(a) Each construction contract awarded by an agency shall include a clause that requires the prime contractor to include, in each subcontract for property or services entered into by the prime contractor and a subcontractor (including a material supplier) for the purpose of performing such construction contract, a payment clause which obligates the prime contractor—

"(1) to pay the subcontractor promptly (as determined in accordance with prevailing industry standards) out of amounts paid to the prime contractor by the agency for work performed by the subcontractor under that contract; and

"(2) to pay to the subcontractor an interest penalty on amounts due in the case of each payment not made in accordance with such payment clause—

"(A) for the period beginning on the day after the required payment date and ending on the date on which payment of the amount due is made; and

"(B) computed at the most current rate of interest that has been determined by the Secretary of the Treasury for interest payments under section 12 of the Contract Disputes Act of 1978 (41 U.S.C. 611) and published by the Secretary in the Federal Register.

"(b) A prime contractor's obligation to pay an interest penalty to a subcontractor pursuant to the payment clause included in a subcontract under subsection (a) may not be construed to be an obligation of the United States. A contractor may not obtain reimbursement from the United States for such interest penalty. A contract modification may not be made for the purpose of providing reimbursement of such interest penalty. A cost reimbursement claim may not include any amount for reimbursement of such interest penalty.".

(b) The table of sections at the beginning of such chapter is amended by striking out the items relating to sections 3905 and 3906 and inserting in lieu thereof the following:

"3905. Payment clause for subcontracts under construction contracts.
"3906. Reports.
"3907. Relationship to other laws.".

LIMITATIONS ON DISCOUNT PAYMENTS

SEC. 8. Section 3904 of title 31, United States Code, is amended by inserting after the first sentence the following: "For the purpose of the preceding sentence, the specified time shall be calculated from the date the invoice under the contract is received by the office or employee of the agency designated by the agency to first receive such invoice until the date of payment.".

REPORTS

SEC. 9. Section 3906(a) of title 31, United States Code (as redesignated by section 7(a)(1), is amended to read as follows:

"(a)(1) By the 60th day after the end of the fiscal year, the head of each agency shall submit to the Director of the Office of Management and Budget a report on the agency's payment practices, including a description of the extent to which those practices satisfy the requirements of this chapter.

"(2) In addition to such other information as may be required by the Director, the report required by paragraph (1) shall include—

"(A) the number, amounts, and frequency of interest penalty payments, and the reasons the interest penalties were not avoided by prompt payment; and

"(B) the number, dollar value, and frequency of invoices paid after the required payment date without payment of an interest penalty, and the reasons no obligation to pay interest penalties was incurred with respect to such invoices or no amount for interest penalties were included in the payments of such invoices.".

IMPLEMENTATION THROUGH THE FEDERAL ACQUISITION REGULATION

SEC. 10. (a) The Federal Acquisition Regulation shall be modified to provide appropriate solicitation provisions and contract clauses that implement chapter 39 of title 31, United States Code, and the regulations prescribed under section 3903 of such title.

(b) The solicitation provisions and contract clauses required by subsection (a) shall include the following matters:

(1) Authority for a contracting officer to specify for a contract or class of contracts a specific payment period, which—

(A) in the case of payments for commercial items or services, is similar to the payment period of periods permitted in prevailing private industry contracting practices;

(B) in the case of payments for noncommercial items and services, does not exceed 30 days unless the circumstances of the procurement action require a longer period for payment; and

(C) in the case of progress payments under construction contracts, does not exceed 7 days, unless the contracting officer determines that the prevailing practice in private construction contracts requires a longer payment period.

(2) Requirements to make periodic payments, in the case of a supply or service contract which authorizes periodic payments and periodic submission of invoices during the contract period, upon—

(A) submission of an invoice for supplies delivered or services performed during the contract period; and

(B) either—

(i) acceptance of the supplies or services by an employee of the contracting agency authorized to accept the supplies or services; or

(ii) certification, by such an employee, that the performance covered by the invoice conforms to the terms and conditions of the contract.

(3) A conclusive presumption that the Federal Government has accepted property or services by the fifth day after the date on which, in accordance with the terms and conditions of the contract, the property

is delivered or final performance of the services is completed, unless the circumstances of the procurement require a longer period for acceptance by the Federal Government and such longer period is specified in the solicitation for such contract.

(4) The limitation that the Federal Government may take a discount offered by a contractor for early payment by the Federal Government only in accordance with the time limits specified by the contractor.

(5) The requirements of section 3902(c) of title 31, United States Code.

(c) The regulations required by subsection (a) shall be published as proposed regulations for public comment as provided in section 22 of the Office of Federal Procurement Policy Act (41 U.S.C. 420) within 120 days after the date of the enactment of this Act.

EFFECTIVE DATES

SEC. 11. (a) Section 3(a)(2) and the amendments made by sections 3(a)(1), 4, 5, 6, 7, and 8 shall apply to payments under contracts awarded during or after the first fiscal quarter which begins more than 90 days after the date of the enactment of this Act.

(b) The amendments made by section 3(b) shall apply to payments under contracts awarded on or after October 1, 1988.

(c) The amendment made by section 9 shall apply to the report required by section 3906 of title 31, United States Code, for each fiscal year beginning after September 30, 1987.

THE PROMPT PAYMENT ACT: S. 328 NEEDED TO IMPROVE GOVERNMENT'S PAYMENT OF BILLS

by
Kenton Pattie
Director of Coalition for Prompt Pay
& Senior Staff Vice President of the
International Communications Industries Association

Statement to:

Senate Committee on Governmental Affairs

Hearing of March 19, 1987

Washington, D.C.

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STATEMENT BY
KENTON PATTIE
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INTERNATIONAL COMMUNICATIONS INDUSTRIES ASSOCIATION

Mr. Chairman:

It is a pleasure to appear before you and before this Committee.

I am speaking this afternoon on behalf of the Coalition for Prompt Pay. I have attached a list of our members (Attachment 1). Our common goal is to support S. 328, which Senator Sasser and Senator Trible and many members of the Senate introduced on January 20, 1987. As of this date, S. 328 has 74 co-sponsors, including members of the Governmental Affairs Committee and Small Business Committee. We are very grateful to the sponsors and co-sponsors.

Mr. Chairman, while from time to time I mention in my testimony the importance of prompt pay to businesses, I feel that what we are really talking about today is:

(1) Making the government a more efficient, reliable business partner.

(2) Enforcing on government a standard of fair play that is no more burdensome than the standard that exists in the private marketplace.

(3) Obtaining for the government a system that will attract the largest number of willing contractors and subcontractors, thus encouraging the greatest amount of competition that will result in the lowest possible prices to be paid by government.

If the Prompt Payment Act were to work correctly, it would encourage companies to compete, give them the assurance that they will not be ruined by an unfair interruption in cash flow, and help them feel that the favorable prices they offer the government will be honored by equally favorable payment practices.

Our four and a half years of experience with this law show there has been significant improvement since 1982. As Director of the Coalition for Prompt Pay, I have received comments from businesspeople indicating that more payments are made on time now than before 1982.

With the direction that implementation of this Act has received from the Office of Management and Budget, some agencies are streamlining their bill-paying procedures. The resulting efficiency benefits the public not only by making the government more cost effective but also more accountable.

And, I'm pleased to report that passage of the Federal law requiring prompt payment of agency bills has provided an incentive for states to take similar action. The total number of states with prompt pay laws is now forty-five (45) plus the District of Columbia. Eleven of the thirteen states represented on this committee have prompt pay laws:

Alabama
*Alaska
Arizona
*Arkansas
California
Colorado
Connecticut
*Delaware
District of Columbia
*Florida
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
*Maine
Maryland
Massachusetts
*Michigan
Minnesota
Mississippi
Missouri
Montana
Nevada
*New Mexico
New York
North Carolina
North Dakota
*Ohio
Oklahoma
Oregon
*Pennsylvania
Rhode Island
South Carolina
South Dakota
*Tennessee
Texas
Utah
*Virginia
Washington
West Virginia
Wisconsin
Wyoming

*Represented on Senate Governmental Affairs Committee

I hope you feel a sense of pride for having launched a national movement because these states certainly got their inspiration from the Prompt Payment Act and all who supported it.

What Has Gone Wrong?

In 1982, there was every indication that the Act would be vigorously enforced by the administration. President Reagan set the tone in a Rose Garden ceremony before he signed the bill:

> "We don't want the government to be a deadbeat, either, so I will soon sign the Prompt Payment Act to make sure the government pays its debts on time . . . government contracts should be paid the same as any other business contracts--on time . . . with the coalition and its help, we're going to get things set straight."

President Ronald Reagan
May 13, 1982 at the White House
Washington, D.C.

But since then, despite an early effort by OMB, the U.S. agencies have made repeated assaults on the intent of the Act. They have taken opportunities to justify paying later, rather than working to pay sooner.

I regret to report they have undermined the intent, spirit and letter of the Act while backing away from the promises of President Reagan. They have proved they are adept at using bureaucratic practices and red tape to restrain the fulfillment of a public law.

Loopholes Routinely Taken Advantage Of

Problems have occurred because agencies have strained to find loopholes to circumvent the law's requirements. These problems are frustrating for the countless businesspeople who expected the law to resolve all of their difficulties with late government payments.

While OMB has helped to implement the Act, we feel OMB will benefit from passage of S. 328 because the bill will strengthen OMB's hand in getting the job done. I can understand why OMB might express some concerns about the bill because after all they are speaking for the many agencies which were not in support of the 1982 Act in the first place. The agencies OMB speaks for are currently reluctant to fulfill the full intent of Congress on this issue and many do not even fulfill the intent of OMB's own regulation on this subject. But, I am equally confident that once this bill becomes law, OMB will embrace it as another valuable tool for obtaining government efficiency.

In the past year oversight hearings on prompt pay were held by both the Senate Small Business Committee and the House Committee on Government Operations. At both hearings, OMB testified and had an opportunity to address complaints raised by the business community. Let me share with the Committee some of the comments made by OMB at the hearings:

> ". . . while we are proud of the progress that's been made since enactment of the Prompt Payment Act, we want to solve the remaining problems that have been identified. . ." Carole J. Dineen, July 29, 1986.
>
> ". . . we plan to revise Circular A-125. . ." Carole J. Dineen, July 29, 1986
>
> ". . . we believe it is better to attack the remaining payment problems directly--by tough management action--rather than trying to change the entire payment system, a system that all acknowledge is working well." James C. Miller, III, June 19, 1986
>
> "We believe these steps . . . can be implemented more quickly than legislative change." James C. Miller, III, June 19, 1986

It is now 8 or 9 months since the above comments were made. Surely enough time has passed for even the Federal bureaucracy to deliver on their promises. Yet OMB has failed to act. Adding insult to injury, OMB has this year failed to produce the annual report of Federal agency performance under the Prompt Payment Act, a report which the law requires to be submitted to Congress within 120 days after the end of the fiscal year. It should have arrived on your desk by the end of January, but still had not been sent by the first week of March. Such a violation of a reporting requirement must not be overlooked because this annual report is a key ingredient to your committee's oversight of the Prompt Payment Act.

OMB does not appear to be listening to Congress nor is it listening to the business community but rather seems to be shifting to the defense of the bureaucrats. It is clear to the Coalition that OMB is unable to solve the remaining payment problems administratively. S. 328 is the needed remedy by your committee to see that your prompt pay goals are carried out without further failures.

For the record, I would like to point out that the U.S. Senate proved its responsiveness to complaints of late pay in 1985 when Senator Sasser included language in the committee report on H.R. 2577, a supplemental appropriations bill for Fiscal Year 1985. The committee report addressed itself specifically to problems encountered with the Department of the Navy as many complaints from contractors at that time involved the Navy. The committee report stated:

> "Prompt Payment Act Compliance - The Committee has received complaints from small businesses that the Department of the Navy is often late in paying bills. Further, the businesses report that in many instances the Navy does not tender late payment interest penalties which are required by the Prompt Payment Act (Public Law 97-177).
>
> The Committee urges the Secretary of the Navy to implement regulations which ensure that proper invoices are paid within 30 days of delivery, upon completion of work, or upon receipt of invoices, whichever is later. The regulations should be designed to eliminate excessive paperwork and delays which appear to be creating unnecessary hardships for small businesses with limited capital."

Mr. Chairman, last year your Committee approved the very same bill we are today discussing (it was then S. 2479) and the full Senate passed the measure by unanimous consent on October 15, 1986. S. 2479 had our full support. We are very grateful for your prompt action on S. 328 this year. We are also particularly pleased that the bill enjoys even stronger support than last year with a total of 74 co-sponsors. We look forward to working with you in resolving the remaining payment problems with agencies. I would like now to address my remarks to those problems and the ways in which S. 328 provides solutions.

I. RECEIVING DELAYS

Problem:

The 1982 Act states that the head of an agency is deemed to receive an invoice on the later of the dates that:

(A) the designated payment office or finance center of the agency actually receives a proper invoice; or

(B) the head of the agency accepts the applicable property or service.

The law and OMB Circular A-125 show the intent in unmistakable terms. For example, A-125 states:

> "Agencies will ensure that receipt and acceptance are executed as promptly as possible. Receiving reports will be forwarded in time to be received by the designated payment office by the fifth business day after acceptance, unless other arrangements are made. Designated payment offices will stamp receiving reports and invoices with the date received in that office."

However, many agencies actually spend months certifying, accepting and receiving goods, services and invoices before forwarding them to the finance office for payment. (See examples from contractors on page 21.) Because the 30-day clock does not run at all during the months leading up to arrival of paperwork in the finance office, companies get very upset. This is true not only in instances where sophisticated defense or space program contracts are involved but also in procurement of everyday off-the-shelf items such as common office supplies. Contrary to the intent of the law, these delays do little to enhance the government's image and, in fact, lend credence to the image of bureaucratic ineptitude. Furthermore, these long delays clearly violate the purpose of the Prompt Payment Act.

Solution (S. 328):

The amendments in S. 328 provide that an agency is deemed to receive an invoice on the later of:

(A) the date on which the office or employee of the agency designated by the agency to first receive such invoice actually receives a proper invoice or

(B) on the fifth day after the date on which property is actually delivered or final performance of service is actually completed unless the contract specifies a longer period.

Coalition for Prompt Pay Comments:

By establishing in the statute a new 5-day standard for receipt of invoice, the bill sets forth a specific requirement that will be less subject to creative misinterpretation. We believe that a solid 5-day receipt and acceptance period would go a long way toward solving the problem. It will work with cooperation from OMB and the agencies. I am confident OMB will help on this because the provision in S. 328 is so similar to OMB's own regulations as quoted above from A-125. The Coalition believes that 5 days is ample time in 99% of the government's payments. Up to 5 days should be the rule and not the exception.

This new 5-day standard begins the 30-day count: (1) on the date on which the office or finance center designated to first receive an invoice actually receives a proper invoice, (2) within 5 days, or (3) on the date set in the contract.

The Coalition's object in supporting this bill is the belief that agencies can move receiving documents and acceptance documents to the payment office within 5 days. This would require, in our opinion, some of the government's receiving sites to use electronic approvals, to pursue rapid return of all paperwork, or to specify in the contract that there are unique reasons why they cannot meet the 5-day standard.

If the 5-day receiving requirement eliminates months of interest-free delay, we will be very happy with this provision. If it is used as an excuse by agencies to automatically extend 30-day payments to 35, the business community will be very unhappy.

What we do not want to see result from S. 328 is for agencies to publish and impose on small firms commonplace contractual terms which impose a mandatory receiving period in excess of the 5 days. Mr. Chairman, I refer to Attachment 2 to my statement which is a form used by the Federal Supply Service of the General Services Administration. You will note that the agency has granted itself an additional full seven days for acceptance of supplies. These seven days are imposed on all companies regardless of the actual time the agencies take to process receiving papers. Added to the 45 interest-free days already allowed by law, this now gives the agency a period of 52 days to make payment and avoid the payment of interest. At the beginning of the Act's implementation, many agencies demonstrated the capability of paying in less than 30 days, but were criticized by OMB for doing so. OMB required them by regulation to make payments as close to the 30th day as possible. So, I am certain that agencies can perform the paying in under 30 days thus making room in the 30 days for some receiving days.

Therefore, if the contract adjusts the receiving period beyond 5 days, then the excess time (beyond 5 days) should be taken out of the 30-day requirement and adjustments should be made accordingly so that the 30-day standard is still met. This suggestion, Mr. Chairman, would require an amendment to S. 328.

Several states including Flórida, Illinois, and Mississippi have adopted this approach by dividing the total payment period into separate periods for the two separate functions of receiving and payment.

Another approach would be to give agencies the flexibility to set their own standards for internal procedures such as receiving, acceptance, and certification provided that the payment is made within the 30 days.

For example: "All proper invoices shall be received, accepted, certified for payment, and paid within 30 days after a properly submitted invoice is actually first received in the designated payment office, provided that the property has been actually delivered or final performance of service actually completed."

This approach would allow each agency the discretion to determine how much of the 30-day period should be consumed by each function: receiving, acceptance, certification and issuance of the check.

OMB's annual report published in compliance with the Federal Prompt Payment Act, measures only the amount of time consumed by the finance office in processing payments. Thus it is not a true reflection of actual late-pay practices by the Federal agencies. The OMB annual report provides no data on the period prior to commencement of the 30-day clock. In addition to the provision in S. 328 requiring that receiving be completed in 5 days, there should also be an amendment requiring OMB to provide data (in its annual report to Congress) on the period beginning immediately after the invoice is physically first received so that agencies will have an additional incentive to improve their performance in receiving, acceptance and certification.

II. ABUSES OF GRACE PERIOD

Problem:

Some Federal agencies are routinely using the 15-day grace period in the Act to extend payment terms. In effect they have turned the 30-day goal set by Congress into a 45-day goal.

Solution (S. 328):

The bill provides for a gradual phase-out of the grace period by reducing it to 7 days through October 1, 1990, then eliminating it altogether thereafter.

Coalition for Prompt Pay Comments:

To its credit, the original Senate version of the Act contained no extra 15-day grace period. The 15 days were added in the House at the request of Defense employees who felt they could not achieve the 30-day standard. However, as the House Committee report stated: "The intent of the Committee that agencies pay their bills by the required payment date is in no way diminished by inclusion of provisions authorizing grace periods."

Despite that clear intent, contractors report to us that some Federal agencies routinely pay their bills within 45 rather than 30 days. Those industries which sell perishable goods, with a short shelf life, complain that while their commercial customers pay in under 20 days (in accordance with food industry terms), government agencies stretch payments up to the 45th day. Let's face it, the government is either paying higher prices for food or other customers are paying for the hidden carrying costs the company is burdened with. Either way the taxpayer is not served by the 15-day grace period. In fact, testimony at the December 2, 1985, Norfolk hearing, which Senator Trible chaired, indicated that 45 days is the average some companies are experiencing with certain Federal agencies. After three years of experience with the 30-day law, agencies should have implemented procedures that comply with the statutory requirements. Therefore, they should no longer need the 15 extra days.

In August of 1986, the General Accounting Office at the request of Rep. Jack Brooks, Chairman of the House Government Operations Committee, published a report entitled, "Prompt Payment Act--Agencies Have Not Fully Achieved Available Benefits." GAO found that about 18% of payments in its study were made during the grace period. The report states, "Paying almost a fifth of the payments during grace periods seems to defeat the purpose of having grace periods."

I might add that businesses find the 15-day "grace period" an abuse and a burden. In the business marketplace the 30 days following receipt of invoice is considered the "grace period." The extra 15 days in the Prompt Payment Act represents a unique privilege of government which undermines the perception of fair treatment for businesses. Once we phase out the extra 15-day bonus period, as proposed by S. 328, government will at last stand on equal footing with other customers and will thus comply with a common industry term.

In monitoring state prompt pay laws, we find that if state legislatures include grace periods they provide for eventual elimination at a pre-determined date provided for statutorily. This is true in New York which will phase in a 30-day standard by 1988 and also in a law passed in 1986 by Wisconsin. Virginia amended its prompt pay law one year after initial passage to reduce its 15-day grace period to 7 days. I feel confident we will eliminate these extra days in Virginia very soon.

We believe that because the Federal Government has had ample time to conform to the 30-day standard the extra 15-day bonus buffer is no longer necessary and should be phased out as proposed by S. 328.

III. INTEREST NOT PAID AUTOMATICALLY

Problem:

Despite the intent of the Act and OMB Circular A-125 which states clearly that an interest penalty will be paid automatically, some Federal agencies fail to pay interest when a check is issued after the prescribed payment period. GAO estimates there are 278,000 unpaid interest penalties every four months for a total of about $15 million. If you contrast this four-month total of $15 million in interest due with the $7 million reported (by OMB) and paid by the agencies during all of fiscal year 1985, it is clear that the government is paying only a fraction of what it owes under the Prompt Payment Act.

Solution (S. 328):

S. 328 clarifies that interest "shall be paid without regard to whether the business concern has requested payment of such penalty." Furthermore, the interest penalty is doubled when a vendor who is owed interest does not receive it with the payment and makes a written demand for interest due.

Coalition for Prompt Pay Comments:

The automatic payment of interest and the increased penalty for failure to comply, as proposed by S. 328 and supported by this Coalition, are fundamentally necessary for several reasons:

(A) The vendor has no method of determining interest in advance since he or she does not know when the check will be issued by the agency.

(B) Rebilling for interest is costly and burdensome to both the government (which has to process the new invoice) and to the company (which has to issue the invoice for an indefinite amount).

(C) The interest rate is recalculated every six months and the government has much easier access to the current interest rate than does the vendor.

IV. PARTIAL PAYMENTS FOR PARTIAL DELIVERIES

Problem:

While the Act made it clear that partial payment is authorized for completed partial deliveries, we continue to get reports from companies saying that agencies are not complying with this provision.

Solution (S. 328):

S. 328 further clarifies the Act's application to partial or periodic payments.

Coalition for Prompt Pay Comments:

More vigorous compliance by the agencies is needed. If an agency receives something it can use, it should pay for it. In the case of perishable foods, for example, delivered food is being consumed while agencies often hold up payment on all items until one item on a long purchase order is delivered.

One firm told me that the Navy will only contract with them if the company agrees to submit monthly statements. What this means is that some partial payments are stretched well beyond 30 days before the monthly bill is submitted by the vendor. This is a clear attempt by the Navy at getting around the partial payment provision this Committee and the Congress put in the Act.

V. PROGRESS PAYMENTS AND RETAINAGE

Problem:

While a progress payment is virtually the same as a partial payment for a partial delivery, some agencies have adopted the position that the Act does not apply to progress payments, particularly progress payments on construction projects. These payments are made by agencies to firms for achieving specific completed milestones along the way toward a finished job.

Solution (S. 328):

The amendments clarify that interest is payable for late progress payments and retained amounts on construction contracts.

Coalition for Prompt Pay Comments:

The Act never exempted progress payments. When OMB proposed removing progress payments from prompt payment coverage in the first draft of A-125, industry objected. OMB revised the Circular and through bureaucratic language appeared to allow prompt payment and interest penalties on progress payments. However, agencies have ignored the Act and the Circular on this point much to the frustration of the construction industry.

Under a progress payment, once agreement is reached by both parties as to the amount of the payment, there should be no more than 30 days from that date in which the agency has to issue the payment. After that, interest should accrue. Retained amounts held more than 30 days should also be subject to interest penalties.

We feel that the only way to resolve this problem is to amend the statute by adding specific language ensuring that progress payments and retained amounts are given the 30-day standard and are subject to interest penalties. S. 328 contains such an amendment which we support.

VI. EARLY PAYMENT DISCOUNTS

Problem:

Some Federal agencies are taking discounts offered by contractors for quick payment (for example within 15 or 20 days from completion of work) although actual payment is made after the expiration of the specified "discount period." For example, a company may offer a 2% discount if the agency will pay within 15 days of receiving the goods, but the agency takes the 2% discount even though paying 50 days after receiving the goods.

Solution (S. 328):

S. 328 states that the specified time for early discount payments shall be calculated from the date the invoice under the contract is received by the designated payment office or finance center until the date of payment.

Coalition for Prompt Pay Comments:

Abuses of the early payment discounts are particularly frustrating to contractors. While agencies take advantage of favorable financial terms, they should not do so when the discount deadline has been passed.

The GAO study estimated that during the four months of its investigation about 146,000 discounts, for an approximate total of $2 million, were unfairly taken by the government after the discount period had expired. (See Examples From Contractors at the end of this statement for illustrations of this problem.)

Companies do not tolerate such blatant disregard for their payment terms from private customers. Why should the Federal Government insist on being treated differently? Even worse, is the fact when some agencies take advantage of early payment discounts they do not even meet the 30 days required by law let alone the early payment deadline. Then they refuse to pay interest penalties. The Coalition recommends that S. 328 be amended so that the penalty is doubled when an agency unfairly takes the early payment discount. The double penalty would work in the same way as the doubling of the penalty for missed interest already in S. 328. This proposed amendment to S. 328

will not cost the government more but will simply help stamp out an abuse of the Prompt Payment Act.

VII. ANNUAL REPORTS

Problem:

Existing law requires the submission of an annual report showing the number, amounts and frequency of interest penalty payments but does not provide any measure of invoices paid after the required payment date for which no interest penalties were included.

Solution (S. 328):

S. 328 specifies that annual reports prepared for OMB would be required (1) to include number, dollar value and frequency of invoices paid late without payment of an interest penalty and (2) to give the reasons no interest was paid.

Coalition for Prompt Pay Comments:

We support this provision. We were particularly pleased that the Act required the Office of Management and Budget to provide annual reports of agency compliance as this gives Congress, the media, trade associations and the public an opportunity to see how the law is working.

However, the information provided in the annual reports is not as complete as it should be. Specifically, the OMB report does not provide any measure of unpaid invoices for which the 30-day clock has not begun to run. By reading this annual report, you cannot find out how many unpaid bills are languishing for months before being forwarded to the payment office for issuance of a check. Therefore, the Committee should require OMB to provide information on how much time is consumed by the paperwork processing that takes place prior to the agency's start of the 30-day clock. In this way, agencies would have to expose any delay problems to Congress and the public.

Furthermore, a report showing a small number of payments incurring interest penalties could mean that the agency is successfully paying its bills on time or it could disguise the fact that the agency does not add interest penalties to payments when they are late. The annual OMB report should tell Congress the incidence of failure to pay interest.

Also, the OMB does not monitor compliance with the 15-day notification requirement. We recommend that this too be corrected as part of S. 328.

Finally, the OMB report provides no information on payments made during the grace period. This lack of information precludes Congress from monitoring abuses of the grace period.

The GAO study confirmed that OMB's claim that 99% of agency payments are made on time was "not an accurate assessment of the government's payment performance." In fact, GAO recommended that future OMB reports include "the number, amounts and percentage of commercial invoices paid during a grace period; and the number, amounts and percentage of commercial invoices paid after any applicable grace period that did not include any late payment penalties." We agree with the GAO proposal.

The Coalition recommends that these four changes in the OMB annual report be specified in the statute.

(A) The report should provide information on the length of time that is consumed by initial processing of invoices before they are forwarded to the payment office for issuance of a check.

(B) The report should provide data on the number, amount and frequency of late payments for which no interest penalty has been paid. Explanations should be included.

(C) The report should include information on whether late payments were preceded by the statutorily required 15-day notification to contractors.

(D) The report should provide data on the number, amount and frequency of payments made during the 15-day grace period.

VIII. SUBCONTRACTOR PAYMENTS

Problem:

Subcontractors on Federal construction projects do not always receive timely payment from the prime contractor even after the prime has been paid by the government for work that the subcontractor has performed.

Solution (S. 328):

S. 328 requires that contracts between prime and subcontractors on Federal construction projects include a payment clause that provides for payment according to prevailing industry standards as agreed to by the major associations representing both general contractors and subcontractors. The bill also entitles the subcontractor to the late payment interest penalties already paid by the government at the same rate paid by the government to the prime contractor.

Coalition for Prompt Pay Comments:

It is important to point out what Section 7 (the subcontractor payment clause) does not do:

(A) Section 7 does not force a general contractor to pay a subcontractor prior to receipt by the general contractor of payment from the Federal Government. In other words, it is not a stiffer requirement than is being imposed on general contractors. Section 7 merely requires a flow-through of the prompt pay requirement so that most businesses participating in Federal projects will be granted the same protection under the law.

(B) Section 7 does no harm to general contractors as it imposes no new conditions that would force them to provide subcontractor payments in the absence of prior payment from the government.

(C) Section 7 does not involve the Federal Government in any disputes between general and subcontractors. Just as the Federal Government is not required to make payment under the Prompt Payment Act for disputed claims, the prime contractor is not required to make payment to subcontractors for disputed claims. I would point out that under most circumstances, work performed by subcontractors on Federal projects is subject to inspection and certification by both the general contractor and the government prior to the government's payment. So in Section 7 we are only talking about payment of proper amounts for work that is not subject to dispute.

Furthermore, the inclusion of Section 7 in S. 328 will encourage more small companies to want to participate in Federal projects. This is a goal of the Prompt Payment Act itself: to make Federal projects desirable to small firms which cannot survive erratic cash flow.

ADDITIONAL PROBLEMS WITH THE PROMPT PAYMENT ACT

The Sasser-Trible bill is a well-prepared and responsive follow-up to the problems discussed by contractors at previous Congressional hearings. We support the bill and pledge to do all we can to strengthen it and advance it through the Congress. Of course, there are other problems that have been brought to our attention through members of our Coalition and I'd like to discuss those as well as some recommended solutions.

U.S. Postal Service

S. 328 quite correctly proposes new language to state that the U.S. Postal Service is subject to the requirements of the Prompt Payment Act with the exception of the reporting requirements. We heartily agree with this amendment and hope that the Committee will make a determination as to whether any other quasi-independent agencies which receive and spend Federal funds are also in need of clarification as to their status for purposes of the Prompt Payment Act. Federal prompt payment requirements should be applied across-the-board to all agencies which procure goods and services. Both Senate and House opposed agency-by-agency exemptions in the 1982 Act and we urge you to again take this firm position against exemptions.

Notification of Defective Invoices

The Act requires that contractors be given notice of an improper or defective invoice within 15 days of receipt of the invoice by the agency. The payment clock is then stopped until a proper invoice is submitted. This provision was put in the law specifically to prevent agencies from allowing unpaid invoices to languish for months before any action is taken. Companies complained to Congress that they were never informed when there was a problem on a contract or invoice . . . they billed repeatedly with no payment being made. This provision was designed to give companies early warning of late payment and to give companies an opportunity to correct errors and mistakes.

Unfortunately, most companies say Federal agencies are ignoring this 15-day provision. Rarely do vendors get notified about problems with their invoices. They have to make phone calls, and often write many letters as well, to find out the status of unpaid bills.

This is an unacceptable situation and represents bureaucracy at its worst. We recommend that the Committee provide a penalty for agencies that ignore this notification requirement of the law. Until there are teeth in this provision, agencies will ignore it. We are of course discussing here a feature related to improper invoices. These are invoices that do not meet the criteria for prompt payment. At a minimum OMB should, in its annual report to Congress, provide information to this Committee and the House Government Operations Committee on the compliance with this 15-day-notification provision. By asking for the information in its quarterly survey of agency payment practices, OMB will inspire some agencies to improve compliance.

Top Financial Officers: Payment Ombudsperson of Last Resort

An often-repeated complaint of vendors is, "If only I could find the right person in the agency to correct this payment problem, I wouldn't have to waste so much time trying to solve it." Anyone who's had any experience at all with the Federal Government knows how frustrating it can be to make numerous phone calls in an attempt to identify the one person who can answer your questions. There is a simple solution: OMB should publish semi-annual listings of the top financial officer in each Federal agency, giving name, address and telephone number. This person would be the office of last resort for a businessperson who simply can't get a response to his or her request for payment of an invoice. This person should act as the payment ombudsperson of last resort--someone who does not buck the problem any further. Again, accountability provides an added measure of efficiency: one that is sorely needed here. This list would routinely be given to vendors by contract and procurement officials.

In addition, agencies should publish advisories to vendors on how to get paid. This information should be made available to every vendor and would go a long way in making sure that invoices are filled out correctly and that complicated procedures--which vary from agency to agency--are met. Contractors at the December 2, 1985, hearing (chaired by Senator Trible) stated that to be paid on time they devote considerable staff time and expense to administration of their Federal contracts. It isn't feasible for every firm to devote the same resources to tracking Federal payments and it shouldn't be necessary if information were more readily available to all companies as we are proposing here today.

The solution should be that OMB through A-125 require every major agency to publish an advisory on "How to Get Paid by This Agency." Some have already done it as we saw at the December 2, 1985, hearing. More should be encouraged to follow suit.

Medicare Payments

In the last Congress, although S. 2479 was the primary vehicle addressing our prompt payment concerns, delayed payment to Medicare providers was approached in a different but complementary manner. Among the Medicare providers and suppliers especially hard hit are the independent retail pharmacists represented by a Coalition member, the National Association of Retail Druggists (NARD), who provide durable medical equipment and related home health products and services to Medicare beneficiaries.

These concerns were highlighted in a special section of the explanatory materials concerning S. 2479 which were prepared by the Senate Small Business Committee (October 15, 1986, Congressional Record). Fortunately, these especially severe cash flow problems, because of the failure of HCFA and its agents to make timely payments, were addressed in the Omnibus Budget Reconciliation Act (OBRA) of 1986 by requiring that claims submitted for Medicare, Part B Services, be paid within 30 calendar days in FY 1987, 26 days in FY 1988, 25 days in FY 1989, and 24 days in FY 1990 and in subsequent years. Initially HCFC announced (on November 1, 1986) that payments would be made no sooner than 28 days and no later than 30 days. But, after increasing Congressional criticism this wrongheaded approach was rejected. Similarly, the Coalition urges that the FY 88 Health and Human Services Department budget request which seeks to repeal the OBRA Medicare Prompt Payment Provision should be rejected and the 1986 amendment mentioned above be vigorously enforced.

Federal Assistance

When the Act was first considered, the Governmental Affairs Committee received testimony that grant and contract recipients at the state and local level were not paying their bills on time when disbursing Federal dollars. In the Act there is a provision which responds to this problem in part by authorizing these organizations to pay interest penalties when they are late. However, the problem persists as is demonstrated by the witnesses who appeared when hearings were held on prompt pay during the past year. They testified that the problem extends beyond grants to also include loans, loan guarantees and mortgage insurance programs. Several associations in the Coalition have identified this as a problem that needs to be solved.

Responding to this problem, we have recommended the Committee request the General Accounting Office to investigate the causes of these payment delays.

For example, there have been numerous reports of delays in progress payments and release of construction retainage under HUD mortgage insurance programs. The Department of Housing and Urban Development could take a leadership role in simplifying the process and promoting prompt pay by mortgage insurance beneficiaries. They could provide the leadership that other agencies need to respond independently to the problem.

But, the Coalition recommends that S. 328 be amended to require organizations receiving or administering Federal assistance to pay bills on time when Federal dollars are being spent. This is only fair. To provide otherwise leaves a loophole: Federal dollars spent by U.S. agencies must be paid promptly, but Federal dollars spent or used as guaranties by non-Federal entities can be paid late with no interest penalties being assessed.

Mr. Chairman, members of the Coalition have spent some time working on a solution to this problem and have prepared draft language for the Committee to consider as an amendment to S. 328. This draft is Attachment 3 to my statement.

Calculation of Interest Penalties

OMB Circular A-125 states: "Whenever a proper invoice . . . is paid after the due date plus 15 days . . . interest will be included with the payment at the interest rate applicable on the payment date."

To illustrate how this requirement may present problems, I ask the Committee's consent to submit for the record a copy of a letter from the Navy concerning a late payment (Attachment 4). As you will note, Captain Harshbarger (who testified at the December 2, 1985, hearing) states that a check for $1,878.39 for interest on a seven-month overdue payment was issued to a firm in Maryland in April 1986. Interest was paid at the rate of 14.375% since "this was the rate in effect on the day the late payment was made." The date speaks for itself in indicating how late the payment was. For the Committee's records, the invoice was dated January 26, 1984, and payment excluding interest was made on August 10, 1984, seven months later. To its credit, the Navy conceded its mistake and corrected the situation.

In this particular example, the contractor benefited from the OMB Circular quoted above. However, it appears that the degree of flexibility awarded Federal agencies by this regulation could result in willful delays of payments during periods when interest rates are expected to drop. For large payments, it could be in the agency's interest to withhold payment until the interest penalty changes to a lower rate.

For example, in June of 1985 it would have been to the government's advantage to delay payments to July 1 because interest penalties dropped from 12.125% to 10.375% and on January 1, 1986, they dropped again to 9.75%, once again tempting some unfair manipulation of government payments.

While the Navy follows the regulations and pays the interest rate that applied on the actual payment date, there is nevertheless an incentive for other agencies to monitor interest rates and schedule their payments in a manner that will result in less payment of interest.

Since the interest penalty was intended to compensate vendors for lost income and the effects of overdue payments on their cash flow, it seems fair to apply the interest rate in effect on the date the payment was due (versus the date the payment was made). This way, the penalty more accurately compensates the business owner for his or her cost of borrowing money to carry overdue government accounts. But whichever system is used (due date or payment date), agencies should be prohibited by Congress, through an amendment to S. 328, from delaying payments to take advantage of sharp interest rate breaks. All bills owed by government agencies should be paid as promptly as possible, regardless of interest rate variables. The Coalition believes this problem should be clarified in S. 328.

Electronic Funds Transfer

At a hearing of the Senate Small Business Committee in Norfolk, VA, in 1985, the possibility of making the government's payments by electronic funds transfer was discussed as a means of speeding up payments. Utilization of this method of payment could solve a number of the problems associated with government payments to small firms.

Recently, a company in Colorado found that wire transfer provided the solution to its late payment problem when a Federal agency said it could not make payment for several months. The agency argued that a changeover in systems resulted in the government's computer being down for that length of time. The vendor asked the agency to type his check on a typewriter but they refused. He then suggested wire transfer. The agency agreed and the problem was solved. While not all agencies are willing to make wire transfers, they ought to be.

The technology exists for thousands of payments to be issued automatically on a certain date and transmitted instantaneously into the bank accounts of vendors. Thousands of reams of paper and hundreds of thousands of paperwork hours could be saved. At the present time, payments of $25,000 and more can be made directly to a company's bank. However, the use of electronic funds transfer does not appear to be widespread within the Federal Government. In fact, it is difficult to obtain information at all about this method of payment and its application to government vendors. In this area, it is clear the government is lagging far behind corporate financial practices.

Senator Trible questioned witnesses from the Department of Navy and General Services Administration at the December 2, 1985, hearing on prompt pay and I would like to repeat their comments on wire transfers for the Committee record:

> Senator Trible: "One suggestion that was made earlier, made in the testimony but actually not spoken, was that the Treasury Department should be permitted to pay via funds transfer directly to banks bills of less than $25,000. Apparently they can do that now on bills of $25,000 or more, but that's their first entry into the wire transfer business, I guess. But it was suggested that they should have the right to make smaller payments as well, which would, of course, be a direct benefit to the small businesses. Any thoughts about that?"
>
> LeRoy P. Boucher, Director of Finance, General Services Administration: "I don't think that process has ever gotten off the ground with OMB yet."
>
> Linda Vandenberg, Director, Financial Management Division, General Services Administration: "It has, for anybody who is on a manual payment. But we had suggested to Treasury that they develop some sort of high-speed interface so we wouldn't have to go from an automated system to a manual system. And they have never gotten it off the ground. It's still in the pilot stage. So we're not paying any--well, very few vendors, by wire transfer in manual payments."
>
> Captain Leo Wardrup, U.S. Navy: "From the point of view of the Fleet Accounting and Disbursing Center, we would have no objection to wire transfers. We now pay all of our civilian employees on the East Coast via electronic funds transfer. So what you're talking about is really nothing different from that. The only thing we have to do is have a certified bank account that these checks can go through. We submit our civilian pay tapes now directly to the Federal Reserve Bank in Richmond, and that eliminates the vicissitudes of the U.S. Mail."

Mr. Chairman, at this point I would like to request permission to insert an exchange of correspondence we had with the U.S. Department of Treasury on this subject (Attachment 5). In this exchange, I attempted to obtain specific information about the Federal Government's use of electronic funds transfer and the government's plans for expansion of the service. As you will note, the reply I received was delayed many months and contained little information.

Small firms and the government would both benefit from an electronic funds transfer system which can make regular payments predictably on time and with a minimal margin for error. I would therefore urge the Committee through S. 328, to request a study of this idea by the U.S. Treasury Department and by any other appropriate Federal agency. The subject of electronic funds transfer would make an excellent topic for a future Government Affairs Committee hearing. We would be glad to help you.

White House Conference on Small Business

Mr. Chairman, in August of 1986, more than 1,800 small business owners from across the country met in Washington, D.C., for the White House Conference on Small Business. Some of the delegates were appointed by members of this committee and by the co-sponsors of S. 328. The conference was preceded by 57 state-level meetings at which delegates were elected and issue resolutions were adopted. The delegates in Washington had to choose from over 2,232 recommendations to adopt a final agenda of 60 priorities. Many of the provisions in S. 328 were included in a recommendation which ranked #32 on the list.

The White House Conference recommendation follows:

> "Prompt pay legislation should be extended to cover postal service and federally assisted procurement and strengthened through an amendment to the 1982 Prompt Payment Act to eliminate the fifteen day grace period; require automatic payment of interest penalties; more clearly define that the entire payment process, including acceptance, must occur within 30 days; include progress payments and retainage; and require prime contractors to pay their subcontractors within seven days after receiving payment from the government or incur interest payment penalties. In addition, when the government pays the prime contractors late, interest payments shall flow through from prime contractors to subcontractors on a pro-rata basis. The prompt payment act shall vigorously be enforced by all branches of government (R.A. 277, Procurement)."

Long Term Contracts

Some government contractors have raised the issue of the applicability of the Prompt Payment Act to long-term contracts which were awarded prior to October 1, 1982. Existing law states, "This Act applies to the acquisition of property or services on or after the beginning of the first calendar quarter which begins more than ninety days after the date of enactment of this Act." Some Federal agencies have used this language to exempt purchases made under long-term contracts from the provisions of the prompt pay law.

The existing provision was designed to prevent the government from bearing the undue burden of applying prompt payment terms to contracts awarded just prior to passage of the law. However, we do not believe it was the intent of Congress that current purchases made under contracts executed before October 1, 1982, should be exempt from prompt pay. The Coalition has recommended to contractors that such contracts be renegotiated to include the prompt payment provisions. Someetimes the government refuses to renegotiate to allow the Prompt Pay Act to apply. Since it seems that many purchases still fall into this category, we think it would be advisable for the Committee to stipulate that agencies should, if requested by vendors, renegotiate any contracts awarded prior to implementation of the Prompt Payment Act in order to bring them in line with current payment practices. The Committee could accomplish this as an amendment to S. 328.

Bureaucratic Nonsense

Attachment 6 to this statement is a letter from the Department of the Air Force to "All Vendors of U.S. Government" stating that the Department can no longer mail remittance checks to vendors without the correct nine digit zip code number. The letter goes on to suggest that failure to include a nine digit zip code number in the vendor's "Remit To" addresses could affect timely payment. Note in particular the agency's own letterhead with a five-digit zip code. This attachment speaks for itself. Since the Act does not require the nine-digit zip code as a pre-condition for prompt pay, neither should the Air Force.

Payment for Substantial Completion in the Construction Industry

While we would like to think that at the end of a construction project the government moves rapidly to finish paperwork, complete the walkthrough, and release all final payments, this often does not happen. Government offices often consume months before releasing final payment, claiming that they are behind in their workload, understaffed, or have employees detailed to other on-going projects.

These delays cause final payments to be withheld far longer than is necessary. Representatives of the construction industry have recommended that the Act be amended to encourage agencies to release payments after "substantial completion" and to place such payments into interest bearing escrow accounts. This procedure would have the effect of helping speed up the final release of the payment and would, through the accumulation of the interest earned on the account, make more fair the final compensation of the company. Therefore, we support the inclusion in S. 328 of the following amendment:

Amendment to Section 5

by striking (4)(B), and
by inserting after clause (4)(A) the following new clauses (B) and (C)

(B) any amounts which have been retained during the performance of the contract and are due to be released to the contractor be placed in an escrow account at prevailing interest rates after substantial completion of the construction; and

(C) amounts placed in the escrow account and accumulated interest will be released to the contractor after final acceptance of the construction

EXAMPLES FROM CONTRACTORS

In conclusion, Mr. Chairman, I would like to illustrate to the Committee typical examples of problems that are brought to our attention by Federal contractors. Here is a list of specific complaints that have come to us recently:

Example 1

An invoice dated November 28, 1986, was sent by a contractor via Federal Express to a DoD agency on November 24, 1986. The agency recorded receipt of the invoice on December 24, 1986, and paid the bill on February 4, 1987, with no payment of interest. This particular contractor has a computerized billing system that automatically rebills Federal agencies when interest penalties are due but estimates that only 10 to 20 percent of bills for interest are paid.

Example 2

A company shared with us the following data on outstanding invoices unpaid by Federal agencies (data supplied March 11, 1987):

Invoice #	Ages Old (Days)	$ Amount Outstanding	
xxxxxxxxx	102	$1,097,324.00	
xxxxxxxxx	102	667,584.00	
xxxxxxxxx	89	80,292.00	
xxxxxxxxx	89	588,808.00	
xxxxxxxxx	89	173,966.00	
xxxxxxxxx	69	264,984.72	
		$2,872,958.72	TOTAL

Average days late: 90
Average Federal bill overdue: $478,826.45
Approximate interest owed by the U.S. Government based on the current Federal interest rate of 7.625%, established by the Department of the Treasury: $54,765.77

Example 3

An invoice dated February 28, 1985, for $6,773.40 was sent by a company to a Federal agency. The agency certified receipt one year later on March 11, 1986, and paid the company on April 3, 1986, in the amount of

$6,434.73. The agency took a 5% discount the company had offered for early payment within 30 days even though payment was made almost 14 months after the invoice date!

The same company provided another example of an early payment discount that was improperly taken by an agency. In this example, an invoice dated September 30, 1986, was paid February 19, 1987, and the agency unfairly took the early payment discount.

Example 4

A company rebilled an agency for interest due on a payment made more than 3 months after the date of invoice. The agency sent a reply saying that since the invoice was not received in the payment office until 3 months after the date of invoice, no interest was required. The company, of course, had sent the invoice to the "Mail to" address on the purchase order, not the payment office. Agency processing then consumed 3 months before the start of the 30-day clock.

See Attachment 7, an article from the October 1986 issue of Ohio Business for additional examples.

ADDITIONAL EVIDENCE FOR THE HEARING RECORD

Last year, the executive branch showed how far they wanted to retreat from the Prompt Payment Act when they published their draft prompt pay regulations to become part of the Federal Acquisition Regulation. The Coalition found many mistakes and shortcomings in the FAR draft which we spelled out for the executive branch. The FAR draft fell extraordinarily short of the intent and spirit of the Prompt Payment Act, was a retreat from the prompt pay goals of President Reagan, and ignored the complaints we had already made on behalf of the business community. In fact, the FAR draft convinced us that the only avenue left to us was the adoption of the Prompt Payment Act Amendments which you have before you today as S. 328.

Mr. Chairman, I ask consent that the Coalition's analysis of the FAR draft be included in the Committee's hearing record on S. 328.

Further, Mr. Chairman, I ask consent that the Coalition's question and answer paper on S. 328 be included in the hearing record. In this paper, we answer the questions most often raised by Senate and House members and their staffs. We feel this information will be useful to those studying the hearing record.

CONCLUSION

Mr. Chairman, on behalf of the Coalition, I want to thank you for the privilege of appearing before you in support of S. 328. We have come to you today because we have been unable to solve the problems short of legislation. We are convinced that S. 328 is the way to ensure a permanent and fair solution. In doing so we are speaking for the 1800 delegates to the White House Conference on Small Business, the delegates to the 1987 conference of the Small Business Legislative Council, and on behalf of the thousands of small firms which have struggled with this problem for years. Thank you for holding this hearing today.

Attachment 1

MEMBERS OF THE COALITION FOR PROMPT PAY

International Communications Industries Association (ICIA)
National Moving & Storage Association (NMSA)
Association for Information & Image Management (AIIM)
Door & Hardware Institute (DHI)
Small Business Legislative Council (SBLC)
American Subcontractors Association (ASA)
National Association of Manufacturers (NAM)
National Small Business United (NSBU)
Coalition for Common Sense in Government Procurement
American Meat Institute (AMI)
American Consulting Engineers Council (ACEC)
Associated Specialty Contractors (ASC)
National Electrical Contractors Association (NECA)
Painting & Decorating Contractors of America (PDCA)
Mechanical Contractors Association of America (MCAA)
Sheet Metal & Air Conditioning Contractors National Association (SMACNA)
National Roofing Contractors Association (NRCA)
National Association of Plumbing-Heating-Cooling Contractors (NAPHCC)
National Association of Retail Druggists (NARD)
National Insulation Contractors Association (NICA)
National Association of Wholesalers (NAW)
National Association of Credit Management (NACM)
International Sanitary Supply Association (ISSA)
Association of the Wall & Ceiling Industries--International (AWCI)
American Association of Nurserymen (AAN)
Associated Builders and Contractors (ABC)
Mason Contractors Association of America (MCAA)

ATTACHMENT 2

I-FSS-800-A (4/84)

PRODUCTION POINT: The offeror shall insert in the spaces below (or by an attachment to the offer if additional space is needed) the names of the manufacturers of the items offered and the address, etc., of the facilities at which the items will be manufactured or produced.

Item No(s)	Name of Manufacturer	Production Point-Name, Address (including county) and Tel No.	DUNS No.

I-FSS-820-A (4/84)

ORDERING ADDRESS: Offerors are requested to indicate below the address(es) to which orders should be forwarded:

____

____

____

I-FSS-916-A (4/84)

PAYMENT DUE DATE:

AGENCY TAKES AUTOMATIC 7 DAYS TO RECEIVE

(a) Payments under this contract will be due on t [illegible] 30th c [illegible] ay after the later of:

(1) The date of actual receipt of a proper [illegible] office designated to receive the invoice, or

(2) The date the supplies are accepted by the G [illegible]

(b) For the purpose of determining the due date for payment and for no other purpose, acceptance will be deemed to occur on the 7th calendar day after the date of delivery of the supplies in accordance with the terms of the contract, unless otherwise specified in the individual purchase order.

(c) If the supplies are rejected for failure to conform to the technical requirements of the contract, or for damage in transit or otherwise, the provisions in paragraph (b) of this clause will apply to the new delivery of replacement supplies.

(d) The date of the check issued in payment or the date of payment by wire transfer through the Treasury Financial Communications System shall be considered to be the date payment is made.

(e) The designated Government payment office for this contract/purchase order is: ______________________________.

(f) The vendor's remittance or check mailing address, if different from the business address is:

____

ATTACHMENT 3

DRAFT

New Section

REQUIREMENTS FOR FEDERALLY ASSISTED ACTIVITIES

(a)(1) The head of the agency shall prescribe standards for use by grantees, loan recipients or mortgage guarantors to provide that payments under contracts and subcontracts made possible by the federal assistance will substantially comply with the requirements for prompt payment prescribed in Sections 3901 through 3905 of title 31, of the United States Code.

(a)(2) The head of the agency shall include procedures by the agency

(A) to authorize release of funds,
(B) to make or to approve certifications,
(C) to make recommendations on payment applications, or
(D) to expedite the processing and payment of billings.

(a)(3) The procedures described in (a)(2) shall be consistent with enabling grantees, loan recipients or mortgage guarantors to comply with the standards established pursuant to (a)(1).

(b) An obligation to pay an interest penalty to a contractor or subcontractor pursuant to agency standards established under subsection (a) may not be construed to be an obligation of the United States. A grantee, loan recipient, mortgage guarantor, contractor or subcontractor may not obtain reimbursement from the United States for such interest penalty and may not request a contract modification or a cost reimbursement for the purpose of obtaining reimbursement of such interest penalty.

FEDERAL PROMPT PAYMENT ACT

ATTACHMENT 4

DEPARTMENT OF THE NAVY
OFFICE OF THE COMPTROLLER
WASHINGTON, D.C. 20350 1100

IN REPLY REFER TO
7200
NCF-214
28 APR 1986

MAY 02 1986

Mr. Kenton Pattie
Director, Coalition for State Prompt Pay
3150 Spring Street
Fairfax, VA 22031

Dear Mr. Pattie:

Reference is made to your letter of April 16, 1986 requesting assistance in resolving an interest payment problem between Substation Test Company and the Department of the Navy.

I am pleased to inform you that check number 03,233,400 was issued to Ms. Green's company on April 23, 1986 in the amount of $1,878.39. The above payment was based on an interest rate of 14.375%. This rate was established by the Secretary of the Treasury under Section 12 of the Contract Disputes Act of 1978 (41 U.S. Code 611). This was the rate in effect on the day the late payment was made.

I sincerely regret any inconvenience experienced by the vendor in this matter. If I may be of any further assistance please do not hesitate to contact me.

Sincerely,

E. D. HARSHBARGER
CAPT, SC, USN
Deputy Assistant Comptroller
[illegible] Management Systems

ATTACHMENT 5

DEPARTMENT OF THE TREASURY
FISCAL SERVICE
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20226

March 10, 1986

Mr. Kenton Pattie, Director
Coalition For State
Prompt Pay
3150 Springs Street
Fairfax, Virginia 22031

Dear Mr. Pattie:

This is in response to your letter to Russ [illegible] requesting information on Treasury's intention with respect to Federal Government payments to vendors by wire transfer. My answers are numbered to correlate with your questions, a copy of your letter is enclosed for ease of reference.

1. Yes. However, due to the high volume of such payments generated by the General Services Administration, the Veterans Administration and the Department of Agriculture's National Finance Center, these agencies have been granted a waiver to Treasury's mandate that vendor payments over $25,000 be made by TFCS (our link to Fedwire).

2. All agencies for which Treasury disburses, except for the three cited above, use TFCS. The information requested in the second question under #2 is not maintained.

3. A few exceptions to the $25,000 threshhold have been granted. Due to the burden vendor payments create for our TFCS mechanism, we are not interested in lowering the threshhold. Instead we are seeking alternative methods via the ACH system to make the smaller vendor payments.

4. This information is not maintained.

5. As noted above, we do not propose to lower the threshhold for wire transfers. Instead we are testing several ACH formats to determine how to expand the use of EFT for vendor payments as well as reduce the strain vendor payments create on our TFCS mechanism.

DIRECT DEPOSIT
ELIMINATES LOST, STOLEN OR FORGED CHECKS

6. These questions are not easily answered. As I mentioned to your secretary March 6, I would like to personally meet with you to explain the full range of actions Treasury is taking to apply electronic funds transfer to vendor payments.

Commitments already made will take me out of the office March 11-14 and March 24-27. If we can get together, even if only by telephone, at any other time in March, please give me a

Sincerely,

Charles F. Schwan III, Director
Program Management Division

Enclosure

COALITION
FOR
STATE
PROMPT PAY

October 11, 1985

Mr. Russell Morris
Assistant Commissioner, Federal Finance
Department of the Treasury
Financial Management Service
Room 600E
Treasury Annex #1
Washington, D.C. 20226

Dear Russ:

A member of our staff recently attended Treasury's special briefing on nationwide issuance of the new government paper check. We were grateful to receive first-hand information on the subject.

We are also interested at this time in obtaining an update of the status of government payments to vendors by wire transfer. It would be most helpful if you or your staff could respond to the following inquiries:

1. Can electronic fund transfer payments be made by the government to all vendors by all Federal agencies if the amount of payment exceeds $25,000?
2. Currently which agencies of the U.S. Government actually use the electronic transfer payment method? Can you provide us agency-by-agency dates showing dollar volume and number of uses versus agency's total payments?
3. Are any exceptions made to the $25,000 threshold and under what circumstances? How can a wire transfer be initiated for an amount under $25,000?
4. Treasury officials state that approximately 60 percent of government payments to vendors in excess of $25,000 are made by wire transfer. Would you give us a full breakdown of this figure, indicating for example, the number of business firms which utilize this payment method?
5. Is the $25,000 threshold scheduled to be lowered in the near future? Who is making this decision? What are the opportunities for public comment on the need for lowering the threshold?

6. What currently is the procedure a business should follow in order to receive government payments by electronic funds transfer?

7. Does the government use more than one system to transfer funds electronically? At the paper check briefing, a chart was present describing the process as one that is primarily used for direct deposit of recurring payments like Social Security benefits but also one which makes it possible to pay multiple invoices from a company supplying different services. While this information leads one to believe that a single system is used by the government, discussions with Treasury staff indicate that separate systems are used for recurring benefit payments and payments to vendors for goods or services. Please help by clarifying this.

Russ, I hope you will be able to assist us in providing our members with this information. Some of the problems involving late payment by government might be eliminated by the increased use of wire transfer. So we'd like to make sure your system is well known and widely understood by vendors. Thank you for your help Russ.

Warmest personal regards.

Sincerely,

Kenton

Kenton Pattie
Director

KP/md

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS 96TH BOMBARDMENT WING (SAC)
DYESS AIR FORCE BASE, TX 79607

ATTACHMENT 6

— 5 Digit code!!?

REPLY TO ATTN OF: ACF

SUBJECT: Zip Code plus 4 digits

TO: All Vendors of U.S. Government

Due to new postal requirements effective 1 Oct 86, we cannot mail remittance checks to you without the correct nine digit zip code number. To continue timely payments of your invoices, please ensure that all of your "Remit to:" addresses reflect the entire correct zip code number.

KERRY [illegible] OGLESBY, Capt, USAF
Chief, Accounting and Finance Branch
Comptroller Division

PROMPT PAYMENT ACT
87-88 AMENDMENTS

CAPITAL CONNECTION
WASHINGTON

ATTACHMENT 7

Agencies told to pay up...on time,

By SHARON GELTNER

Expect Congress to pass a bill to help businesses get paid promptly — instead of facing interminable delays — by their biggest customer: the federal government.

Congress wants to plug loopholes created in the 1982 Prompt Payment Act, which requires federal agencies to pay their bills within 30 days, or pay interest. The law also provides agencies with a one-time grace period of 15 days or less for agencies to meet their obligations. Agencies will face interest penalties beginning on the 31st day if they fail to pay within this 45-day period.

However, the interest payments must come out of the agency's existing operating budget, and no additional monies may be appropriated to cover them.

That's the way it works in theory. While the law improved the payment patterns of many federal agencies, there are many that refuse to pay on time, whether through carelessness, inefficiency, or stubbornness.

"While all indications available to us suggest that the law has brought about a very substantial improvement in the government's bill-paying practices, there have been reports that some contractors have waited as long as 180 days to receive payment, often without the interest due. Such practices fly in the face of congressional intent and must be remedied," said Senator Lowell Weicker (R-Connecticut) at hearings this summer.

"Small businesses have enough difficulty in retaining and attracting capital, and should not be forced to borrow capital simply because the federal government cannot, or will not, pay its bills on time. The Prompt Payment Act was created to ease the unnecessary burden heaped on small businesses, and we must make sure that the federal government is complying with this mandate," Weicker, the chairman of the Senate Small Business Committee, said.

Added Senator Paul Trible, (R-Virginia), "Many contractors have experienced great difficulty in receiving timely payments . . . we want to explore how serious this problem is and what actions may be needed to correct it."

STIFFER LAWS

Businesses in Ohio have joined the Washington, D.C.-based Prompt Pay Coalition to lobby for stiffer payment laws, on the federal and state level, says Kenton Pattie, a Coalition official.

"Problems abound. A Cleveland audio-visual producer has been owed $11,000 since November 1984 by the Army Reserve in St. Louis, Missouri. One excuse has been that the invoice was lost in a file at the Pentagon," Pattie says.

Carl Knochleman, comptroller of Hamilton Sorter Co., a furniture company in Fairfield, Ohio, has similar problems with the Veteran's Administration, Walter Reed Hospital, and ironically, the Department of Justice.

"Often the system will pay only part of the invoice for no reason. You can't hang your hat on when they will decide to accept the invoice, even though the law is that the invoice date is at the time when the merchandise is received," Knochleman says. If his company goofs and forgets to ship one piece, or one is damaged, the government will not start the clock running on payment until the replacement has arrived, he adds.

"Or, someone will be on vacation and not write up the shipment, so they don't know it's been received. Or, they take discounts for quick payments even if they paid late. I've got receivables on the books over one year old. At best, this is aggravating," Knochleman says.

He has never taken an agency to court because it would be "cutting off your nose to spite your face," Knochleman explains.

Knochleman theorizes that the agencies are supposed to take a discount for quick payment to avoid a black mark.

"It's a doggone nuisance. One of the agencies took a $1,700 discount and had to re-do its paperwork. They knew in the first place they had paid in 35 days and not five days," he says.

"A lot of these people in the bureaucracy couldn't care less.

"The way these people lose paperwork is incredible. If this happened at my office I'd fire everyone and hire a new crew," Knochleman says.

Sometimes Hamilton Sorter writes off the smaller bills, such as a $400 discount the government took for early payment, though it was late. "We want to stop throwing good money after bad.

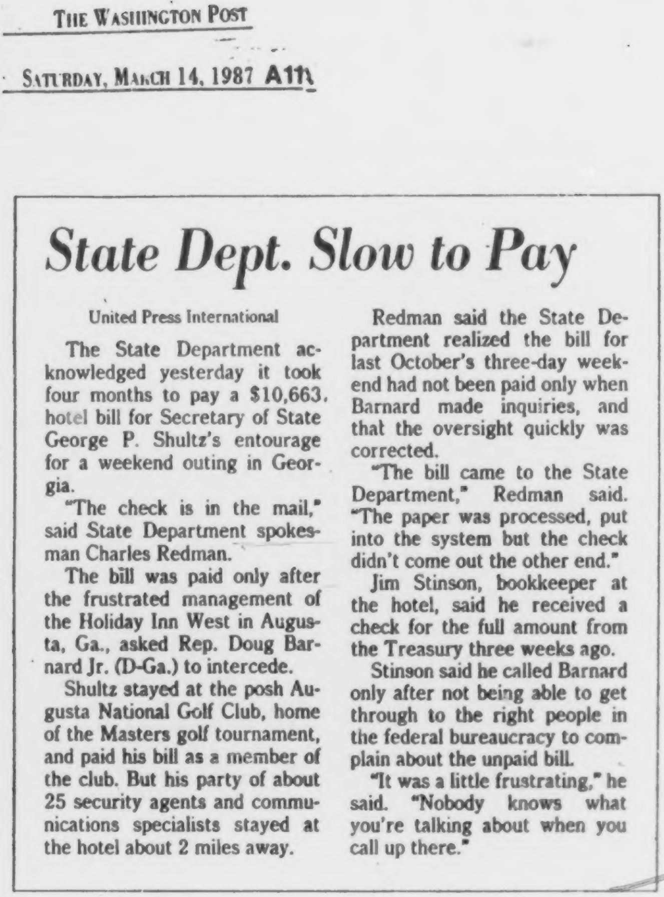
"However, if it's an account of $100,000, we follow up . . ." Knochleman says.

Among the practices Senate staffers says are illegal are:

- Paying beyond the payment date specified in the contract, or Act, without interest.
- Taking discounts for early payment, although payment is made after the discount period.
- Routinely paying invoices late under the 15-day grace period. (This is legal but unethical).
- Rejecting invoices as not proper after the expiration of the grace period.
- Wanting resubmission of invoices when queried about a lost payment, maintaining the previous invoice had been lost—which starts the clock running once again. (It is hard to prove that the original had deliberately been lost.)
- Refusing to pay interest on late payment of "progress payments" on contruction contracts, saying that the payments aren't based on government acceptance of partial performance.
- Refusing to pay interest on late payments for utility services. ■

Attachment 8

PROMPT PAY
PROMPT PAYMENT ACT
87-88 AMENDMENTS



THE WASHINGTON POST

SATURDAY, MARCH 14, 1987 A11

State Dept. Slow to Pay

United Press International

The State Department acknowledged yesterday it took four months to pay a $10,663 hotel bill for Secretary of State George P. Shultz's entourage for a weekend outing in Georgia.

"The check is in the mail," said State Department spokesman Charles Redman.

The bill was paid only after the frustrated management of the Holiday Inn West in Augusta, Ga., asked Rep. Doug Barnard Jr. (D-Ga.) to intercede.

Shultz stayed at the posh Augusta National Golf Club, home of the Masters golf tournament, and paid his bill as a member of the club. But his party of about 25 security agents and communications specialists stayed at the hotel about 2 miles away.

Redman said the State Department realized the bill for last October's three-day weekend had not been paid only when Barnard made inquiries, and that the oversight quickly was corrected.

"The bill came to the State Department," Redman said. "The paper was processed, put into the system but the check didn't come out the other end."

Jim Stinson, bookkeeper at the hotel, said he received a check for the full amount from the Treasury three weeks ago.

Stinson said he called Barnard only after not being able to get through to the right people in the federal bureaucracy to complain about the unpaid bill.

"It was a little frustrating," he said. "Nobody knows what you're talking about when you call up there."

United States General Accounting Office

GAO Testimony

For Release
on Delivery
Expected at
2:00 p.m. EST
Thursday
March 19, 1987

Federal Agencies' Bill Paying Performance and Comments on S. 328, a Bill to Amend the Prompt Payment Act

Statement of
Jeffrey C. Steinhoff, Associate Director
Accounting and Financial Management Division

Before the
Committee on Governmental Affairs
U.S. Senate

Mr. Chairman and Members of the Committee:

We are pleased to be here today to talk about the results presented in our August 1986 report on bill payment progress and to offer our views on S. 328, a bill to amend the Prompt Payment Act, which this Committee was instrumental in passing. We generally agree with the provisions of S. 328 and support the Committee's efforts to strengthen this important legislation. We would like to offer a number of suggested changes--primarily of a technical nature--to the current language of the bill.

We have a long-standing interest in upgrading agencies' payment-timing performance. Our 1978 report[1] and several testimonies on this topic before Senate and House committees contributed to passage of prompt payment legislation in 1982. Also, last summer we testified before the Legislation and National Security Subcommittee of the House Committee on Government Operations and issued a report[2] on how well federal agencies were complying with this law.

Clearly, agencies have achieved some of the improvements sought by the act and the related Office of Management and Budget

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[1] The Federal Government's Bill Payment Performance Is Good But Should Be Better (FGMSD-78-16, February 24, 1978).

[2] Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits (GAO/AFMD-86-69, August 28, 1986).

(OMB) regulations and Department of the Treasury initiatives. Compared with the results presented in our 1978 report, our 1986 report showed that agencies had noticeably reduced the percentage of early and excessively late payments. In fact, reductions in early payments saved the government millions of dollars in annual interest costs. At the same time, fewer excessively late payments no doubt helped to ease some companies' cash flow problems.

However, agencies' performance was still short of that envisioned by the 1982 act. About one-fourth of the commercial payments were still late, and required interest penalties were often not paid. Another fourth was paid early and we estimate that such early payments cost the government about $200 million in interest during a 4-month period. Finally, considering the requirement to pay by due dates and prudent cash management principles which counsel against paying too early, agencies only paid about half of their commercial bills within the period considered as "on time."

Before proceeding further, we should note that OMB and the agencies are taking some corrective actions. Satisfactory completion of those initiatives, including several which are very similar to provisions in S. 328, should help improve payment timing. However, we recognize that mandating certain matters by law will underscore the urgency to accelerate the management and administrative initiatives required to achieve prompt payment objectives.

Changing the Starting Point for Payment Periods

The proposed bill would modify the criteria for establishing due dates for goods and services acquired under contracts that do not contain payment-timing terms. Like the existing provisions in the Prompt Payment Act, the bill would define the beginning of a payment period as the later of two events: (1) receipt of an invoice or (2) acceptance of goods or services as satisfactory. However, the bill would establish a "conclusive presumption" that, unless the applicable contract states otherwise, acceptance will legally be deemed to occur on the fifth day after the goods are delivered or services are completed. Thus, under certain circumstances, the bill would require using presumed rather than actual acceptance dates for calculating the beginning of a payment period.

We believe that this proposed change is intended to avoid situations in which vendors have satisfactorily carried out their obligations but payment due dates are unreasonably extended because agencies did not accept goods or services in a timely fashion. We agree with the apparent intent of these provisions, but we have some concerns with the present wording of the bill.

First, agencies sometimes accept goods or services on the same day they are delivered or performance is completed. The bill, as currently drafted, could unnecessarily delay payment in instances when actual acceptance of goods or services occurs before the end of the 5-day period. To prevent payment delays in such instances, we suggest that the acceptance date for purposes of calculating payment due dates should be the actual acceptance date, or the fifth day after goods are delivered or services are completed, whichever is earlier.

Our main concern, however, is that using a "conclusive presumption" of acceptance as presented in the bill could be interpreted as preventing agencies from rejecting unsatisfactory merchandise or services if they do not do so within 5 days (or another contractually specified period) after delivery. The section-by-section analysis accompanying the bill does not seem to envision such an effect. We suggest that any amendment along these lines clearly spell out that it applies solely for purposes of establishing due dates and calculating interest penalties and that penalties should not be due if goods and services are rejected sometime after the 5-day period. Effective internal controls over disbursements generally require actual acceptance before payment is made. This sound management practice should continue.

Another provision in the bill would clarify where an invoice must be received in order to start the payment clock. It would establish the invoice receipt date as the day the designated "office or employee of the agency" first received it. We suggest substituting "place or person" for the above phrase to cover those instances when vendors are instructed to send their bills to points outside of an agency.

To illustrate, the Department of Housing and Urban Development (HUD) has designated local real estate companies to manage HUD-owned properties. They arrange for repairs, accept resulting work as satisfactory, and receive invoices for work performed. They then forward the invoices to the appropriate HUD office for final approval and subsequent payment directly to the contractor who performed the work. We found that, in some instances, HUD improperly calculated payment due dates by basing them on when the HUD office had received the invoices from the real estate companies rather than on when the companies had received the invoices from the vendors. Several payment centers in other agencies followed similar practices. Such practices can result in payments that are sufficiently late to require interest penalties, which agencies may not pay.

Our suggested change should help ensure that due dates--and the decision as to whether agencies owe interest penalties--are based on when invoices are initially received at the designated point.

Finally, some causes of late payments cannot be effectively addressed through legislative changes. For example, incomplete data and delays in forwarding receiving/acceptance reports to payment centers were a major cause of late payments. Without adequate internal controls to ensure that such documents are completed properly and forwarded promptly, the proposed 5-day period may not significantly decrease payment delays. In fact, adopting the 5-day rule could increase the percentage of payments requiring interest penalties. This potential increase emphasizes the importance of our recommendation that agencies forward acceptance documents to appropriate payment centers in the short time frame required by OMB.

Invoices Required for Periodic Payments Under Supply and Service Contracts

Another objective of the bill is to clarify that the provisions of the act apply to various periodic payments authorized under some supply and many service contracts. However, as currently worded, the bill may inadvertently impose additional administrative requirements on vendors and agencies.

Currently, the act does not require vendors to submit invoices for all periodic payments. The proposed bill states that periodic payments for supplies or services are to be conditioned on either acceptance of or certification that goods or services are satisfactory and on receipt of an invoice.

GSA pays for some services--like rents--without requiring vendors to submit invoices at monthly or other intervals. Instead, based on rental agreements, payment systems are programmed to automatically pay set amounts at prescribed intervals through the end of the contract period. This helps ensure timely payments, reduces administrative costs to both the agency and the vendors, and concurrently provides controls over payment amounts and periods. We suggest modifying the bill to avoid requiring invoices in circumstances where they are not necessary to ensure good internal controls over disbursements.

No Invoices Required for Some Food Items

Conversely, in the interest of improving internal controls, we suggest that the Committee consider requiring vendors to submit invoices before being paid for meat items and perishable agricultural products.

The Prompt Payment Act currently calls for calculating payment due dates for such purchases based solely on when the product is delivered. Applying this criterion, we found that interest penalties were due on some of our sample payments even though vendors had not submitted invoices by the due dates. Agencies have to choose between paying interest penalties or observing good internal controls which, in these instances, would call for receiving an invoice prior to payment. One control feature is to use invoice numbers as part of an automated edit check to prevent duplicate payments.

The proposed bill does not address payments for meat items and perishable agricultural products. We suggest adding invoice receipt dates to the Prompt Payment Act's existing criteria for calculating payment due dates for such products. Thus, the specified payment period would commence either on the date a proper invoice is received at the designated location or on the date the products are delivered, whichever is later.

Late Payment Penalties

The bill would require agencies to pay double interest penalties if they do not automatically pay any penalties due and if a vendor subsequently writes to ask that such penalties be paid. We agree that agencies should pay penalties they owe. Doubling penalties would be a strong incentive to do so. We are not aware of any similar practices the private sector.

We noted that agencies often did not pay required interest penalties. This was more often the result of poor management and administrative controls rather than of any purposeful withholding of penalty payments. Paying closer attention to details such as contract payment-timing terms and other improvements as recommended in our report would increase the percentage of on-time payments as well as help ensure that any required penalties are paid. We believe that the requirement for more detailed reporting of agencies' payment-timing performance--and the promised validation of the information by agency inspectors general--will also be a strong incentive for agencies to pay penalties when due.

Eliminating Grace Periods

The bill would eventually eliminate grace periods--periods during which agencies may pay bills late without incurring interest penalties. While we understand vendors' concern about grace periods, we see merit in keeping some grace periods but perhaps shortening the 15-day period. Completely eliminating grace periods will increase the government's administrative costs for paying commercial bills and result in further delays for some payments.

This applies especially to civil agencies which do not issue their own checks but, instead, send schedules of approved payments to the Treasury for check issuance on a specific day. Delivery time to the Treasury--mostly by mail--can fluctuate considerably, and Treasury processing time can take somewhat longer than anticipated. Agencies cannot fully compensate for these factors because payment centers (1) attempt to send to the Treasury only one schedule of payments due on a particular day and (2) generally do not finalize and forward such schedules until about 5 days before the due date.

There are valid reasons for the payment centers' actions. In the interest of efficiency, the Treasury wants payment schedules recorded on magnetic tape to include at least 100 payments. Also, Treasury issues all checks for payments listed on a schedule on the same day. Consequently, hundreds of low-volume payment centers generally must consolidate all or most of their invoices due on the same date on one schedule if they want to use an automated payment process. However, documentation needed to ensure that the payments are proper (such as invoices and receiving reports) frequently does not arrive at the payment center until just before the due date. Thus, forwarding schedules earlier than 5 days before the due date would almost certainly require that all, or additional, schedules be prepared manually. This would be less efficient and increase the risk of making duplicate payments because manually processed payments bypass certain critical automated systems checks and edits.

Also, eliminating grace periods could further delay some payments. The Treasury may only issue checks in amounts authorized by an agency. Therefore, if checks could not be issued by due dates, the Treasury would have to return the particular payment schedules to the respective agencies to obtain approval to pay late payment penalties. This would become particularly important if the double interest penalty provision included in this bill became law. However, returning the schedules would delay these payments even further and add additional administrative costs to both the Treasury and the agencies.

Finally, eliminating grace periods may encourage agencies to make payments before they are due in order to avoid incurring interest penalties. Although this would benefit vendors, we estimated in August 1986 that federal interest costs attributable to early payments far exceeded the amount of penalties owed to vendors for late payments.

Although we estimated that agencies made about 15 percent of commercial payments during grace periods, we did not find intentional abuses such as routinely paying as closely as possible to the end of such periods. Instead, most grace-period payments were made within 5 days after the due date. Also, when the Prompt Payment Act was passed in 1982, short delays in payments were not the issue. Instead, contractors and their representatives pointed out that payments which were delayed for 3 or 4 months or even longer were the problem. An alternative might be to shorten the current 15-day grace period to 10 or perhaps 7 days. This would be more equitable to vendors and would not disrupt agency payment operations.

Discount Periods

Two sections of the bill seem to offer conflicting guidance regarding the start of discount periods. One appears to provide uniform criteria by defining the beginning of discount periods as the date an agency receives an invoice. Another states that agencies may take discounts only in accordance with vendor terms.

Adding due-date criteria for discounts would result in more uniform contract terms. Uniformity, whenever possible, is desirable because we found that varying payment terms were one of the primary causes for improperly taken discounts. However, we believe that the terms as defined in the bill should apply only if the pertinent contract and invoice are silent on the matter. Also, we would prefer the discount starting-date rules already established in the Federal Acquisition Regulation (FAR). These start discount periods after receipt of the invoice or delivery of the goods or services, whichever is later. Such terms seem equitable to vendors because both events are usually under their control. In addition, the FAR terms ensure that agencies have time to inspect goods or services before the end of the discount period, thus allowing them greater opportunity to take offered price reductions.

Reporting Payment-Timing Performance

The bill expands agency reporting requirements for late payments but does not address two factors which contributed to OMB's overstatement of payment-timing performance.

Some agencies based their performance data on the number of invoices for which they had paid interest penalties. Others reported based on the number of checks issued--checks which often cover numerous invoices. We also noted that some contracts for utilities call for prescribed late payment penalties rather than interest when bills are paid late. Some agencies did not report such penalties because the law and OMB's regulations call only for reporting interest penalties.

To ensure consistent and comprehensive reporting, we suggest that the term "payment" as used in the bill, in reference to reporting requirements, be changed to "invoices." Also, the reporting requirements should be augmented to include both interest penalties and other kinds of late payment charges. OMB agreed with our recommendations in this area and has used the suggested language when calling for fiscal year 1986 payment-timing information from agencies. Also, OMB is currently in the process of incorporating such language in its prompt-payment-related regulations.

Implementation Through the Federal Acquisition Regulation

The bill would require including solicitation and contract clauses regarding due dates in the FAR for use by contracting officers. This would include authority for varying due-date terms for different products. We strongly agree that the FAR should contain due-date provisions, and we understand that, considering the wide range of goods and services agencies procure, some flexibility in setting due dates is needed. However, we caution that the bill as currently worded may result in a wide variety of payment periods. This increases the risk of errors in determining when payments must be made.

As stated in our August 1986 report, a primary cause of late payments was the lack of simple, uniform payment terms. Our ongoing work in this area appears to reinforce this point. We continue to believe that payment-timing performance can be substantially improved and administrative costs reduced by requiring agencies to use standard clauses, including specified payment periods, in contracts. Different payment criteria may be appropriate for items that require extensive testing before accepting them as satisfactory. However, optimum assurance that payments will be on time calls for minimizing such exceptions.

On a related matter, the bill would require that progress payments under construction projects be made within 7 days unless prevailing industry practice allows more time. Project diversity, the billions of dollars involved, and the fact that many agencies need up to a week just to process payments create some concerns about establishing such a short payment period. Also, purely from an economic standpoint, even small shifts in payment timing can change federal interest costs by millions annually. It is important that the government receive appropriate compensation--such as adequate consideration in setting prices for earlier payments. Otherwise, overall federal costs will increase.

Reducing Bill Payment Work Load

We continue to work with OMB and other federal agencies to improve the timeliness of vendor payments. A matter not requiring legislation but with potential for savings is reducing the number of bills the government must handle. Statistics we gathered during our 1986 review indicate that about 26 percent of commercial bills agencies receive may be for $100 or less. Considering that agencies annually pay about 30 million invoices, there could be about 7 million bills with invoice amounts of $100 or less.

To demonstrate this point, one of the GSA transactions we reviewed involved a payment for $998.25. This payment was supported by 64 bills from the same company, due on the same day, with individual invoice amounts ranging from $1.75 to $90. Seventeen of these were for $1.75 each. Processing a bill for payment is very labor intensive and generally requires handling by several individuals regardless of the invoice amount. Therefore, we wrote to the Deputy Director of OMB on January 12, 1987, and suggested that it may be appropriate to explore ways to cut down on the volume of bills that have to be paid.

One technique for reducing the number of invoices an agency must handle is to arrange for summary billing with the vendor when contracting for goods or services which otherwise would result in numerous small bills. Such arrangements could specify monthly or other summary billing intervals. This practice would also reduce vendors' invoice preparation and mailing costs. With fewer invoices to handle, agency payment centers could eliminate some of their bill processing backlogs and payment clerks could better ensure that payments are made in accordance with contractual payment due-date terms.

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In conclusion, Mr. Chairman, while offering some technical suggestions, we support the thrust of S. 328. We have recently provided more detailed comments on S. 328 to the Senate Committee on Small Business which we would like included for the record. We are prepared to continue working with the Congress on this matter. We would be pleased to respond to any questions you and the other committee members may have at this time.

GAO
United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

March 13, 1987

B-223690

The Honorable Dale Bumpers
Chairman
Committee on Small Business
United States Senate

Dear Mr. Chairman:

In response to a request received from your office on March 4, 1987, we are providing our comments on a bill to amend the Prompt Payment Act, Public Law 97-177. S. 2479, which was passed by the Senate in October 1986, was reintroduced in January 1987 by Senator Sasser as S. 328, the "Prompt Payment Act Amendments of 1987." The proposed legislation reinforces the Congress' desire that agencies pay the commercial sector on time for the $200 billion in goods and services they purchase annually. The bill currently before the Congress, S. 328, is identical to S. 2479. Therefore, our comments refer to specific provisions in S. 328.

We generally agree with the provisions of S. 328. However, we offer a number of suggested changes--primarily of a technical nature--to the current language of the bill. Although the Office of Management and Budget (OMB) and other agencies have started some of the corrective actions addressed in this bill, we recognize that mandating certain matters by law will underscore the urgency for expediting implementation of necessary corrective actions by responsible parties.

We have a long-standing interest in improving federal agencies' payment-timing performance. Our 1978 report[1] and several testimonies on this topic before Senate and House committees provided information on payment-timing performance and causes of problems in this area. These activities served as the basis for passage of the Prompt

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[1] The Federal Government's Bill Payment Performance Is Good But Should Be Better (FGMSD-78-16, February 24, 1978).

Payment Act in 1982. Last summer we testified[2] before the Legislation and National Security Subcommittee, House Committee on Government Operations, and issued a report[3] on governmentwide compliance with this law.

Our August 1986 report showed that federal agencies had achieved some of the intended payment-timing benefits of the Prompt Payment Act as well as some of the related OMB regulations and Treasury initiatives. Compared with statistics we reported in 1978, agencies had noticeably reduced the percentage of early and excessively late payments. Reductions in early payments saved the government millions of dollars in interest costs annually. At the same time, there was a general consensus among vendors--confirmed by our review results--that fewer payments were made well after due dates.

However, we also found that federal agencies' payment performance was still short of that envisioned by the 1982 legislation. About a fourth of commercial payments were still late, and required interest penalties frequently were not paid. If we consider the legislative requirement to pay no later than the due date and prudent cash management principles that counsel against paying too early, federal agencies made only about half of their commercial payments within the time frame that is considered "on time."

Modifications proposed by S. 328 touch on many of the causes of late payments addressed in our 1986 report. Some of the possible corrective actions we recommended in that report are already underway as administrative initiatives. For example, OMB has expanded agencies' fiscal year 1986 reporting requirements to include information on payments made during grace periods and on payments for which penalties were due but not paid. To ensure accurate reporting, agencies' inspectors general have agreed to validate the information agencies submit to OMB for consolidation in the annual reports to selected congressional committees. These annual reports are required by the Prompt Payment Act. We believe that these initiatives will lead to more accurate reporting and that highlighting poor performance and problem areas will generate incentives to further improve agencies' performance in this area.

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[2] Testimony entitled "Federal Agencies' Bill Paying Performance" (July 29, 1986).

[3] Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits (GAO/AFMD-86-69, August 28, 1986).

In addition, OMB has directed heads of executive departments and agencies to review and strengthen internal controls over vendor payments. They are to report deficiencies in the implementation of the Prompt Payment Act as material weaknesses under the Federal Managers' Financial Integrity Act and to provide a status report and plans for corrective actions. Finally, OMB has pledged to revise its prompt payment-related regulations, contained in Circular A-125, to incorporate the expanded reporting requirement for future years and to augment its guidance on other matters as recommended in our report.

Such initiatives, and satisfactory completion of ongoing efforts to include prompt payment requirements in the Federal Acquisition Regulation, should help to realize the basic objective of paying commercial bills when due, rather than too late or too early. We believe that passage of the proposed legislation will put additional emphasis on the need to expedite the required corrective actions.

Our detailed comments on specific provisions of S. 328 are provided in enclosure I. We are also enclosing a copy of our July 1986 testimony and a copy of our August 1986 report. We hope that our views will be helpful during your deliberations. We are available to offer any additional assistance you may need.

Sincerely yours,

Frederick D. Wolf
Director

Enclosures - 3

DETAILED COMMENTS ON S. 328

Modifications proposed by S. 328 include changing the criteria for calculating payment due dates; phasing out grace periods; in some instances, doubling the amount of late payment penalties; and requiring late payment interest penalties on some types of transactions currently exempt from such penalties. The bill also defines the period during which a prompt payment discount may be taken, expands reporting requirements for late payments, and requires developing solicitation and contract clauses for inclusion in the Federal Acquisition Regulation (FAR). (The FAR contains procurement policy to be followed by executive agencies.)

The Office of Management and Budget (OMB) and the major federal purchasing agencies which are jointly responsible for governmentwide procurement regulations are taking steps to improve payment-timing performance in response to recommendations we made in our August 1986 report. OMB has expanded agencies' fiscal year 1986 reporting on payment-timing performance and is currently in the process of including this provision in its Circular A-125, the implementing regulation for prompt payment legislation. Although the promised circular changes have not yet been published in the *Federal Register*, they are to be similar to several of the Senate bill's provisions.

Also, in July 1986, the Department of Defense (DOD), the General Services Administration (GSA), and the National Aeronautics and Space Administration (NASA) published proposed changes to the FAR that would provide agencies' procurement personnel more detailed prompt payment guidance. According to a DOD official who is responsible for initiating these changes, comments received on the July 1986 proposals in the *Federal Register* have been evaluated. He told us that a new set of proposed changes, very similar to those contained in this bill, will be published shortly.

Changing the Starting Point for Payment Periods

Section 3(a) would modify the criteria for establishing payment due dates for goods and services acquired under contracts that do not contain payment-timing terms. Section 10(b)(3) of the bill would prescribe required changes to the FAR to accomplish the purposes of section 3(a). Like existing provisions of the Prompt Payment Act, the bill would effectively define the beginning of a payment period as the later of two events: (1) receipt of an invoice or (2) acceptance of goods or services as satisfactory. However, sections 3(a) and 10(b)(3) would establish a "conclusive presumption" that, unless otherwise provided in the applicable contract, acceptance will be legally deemed to occur on the fifth day after the goods are delivered or services are completed. Thus, under certain circumstances, the bill would require using presumed, rather than actual, acceptance dates for calculating the beginning of a payment period.

We understand that this proposed change is intended to avoid situations in which vendors have satisfactorily carried out their obligations, but payment due dates are unreasonably extended because agencies do not accept the goods or services in a timely fashion. We have some concerns with sections 3(a) and 10(b)(3) as they are presently worded.

First, agencies sometimes accept goods or services on the same day they are delivered or performance is completed. Adoption of current language in the bill could unnecessarily delay payment in those instances when actual acceptance of goods or services occurs before the end of the 5-day period.

Second, although we agree that agencies should not take unreasonable amounts of time to accept or reject goods or services, we do not believe that establishing a "conclusive presumption" of acceptance is an appropriate solution to the problem. Our basic concern is that the language of sections 3(a) and 10(b)(3) could conceivably be interpreted to preclude the government from rejecting unacceptable goods or services after expiration of the 5-day period or require the government to pay interest penalties on goods or services which are rejected after that period. We understand from the section-by-section analysis which accompanies the bill that these results were not intended. However, the process of accepting goods or services is an important function affecting billions of dollars annually which, in our view, should not be legally "presumed" to have occurred.

We believe that effective internal controls over disbursements should require actual acceptance of goods or services as satisfactory before payment is made. This is a sound management policy which agencies should continue to follow. In our opinion, if a legislative change as proposed by S. 328 is made, it should be made clear that actual acceptance should generally precede payment, regardless of whether doing so results in an interest penalty.

Applicable language in the bill should be modified to clarify that the 5-day (or other contractually established) acceptance period provisions (1) are applicable only if actual acceptance has not occurred earlier, (2) are only to be used for the purpose of determining the period in which payment must be made in order to avoid incurring interest penalties, (3) are not intended to suggest that, as a matter of law, agencies which take more time to accept or reject goods or services cannot reject them after expiration of that period, and (4) are not intended to result in assessment of late payment interest penalties for goods or services which are rejected after expiration of that period.

Another modification we suggest for section 3(a)--and for section 8 (limitations on discount payments) as well--involves substituting "place or person" for the phrase "office or employee of the agency" in the definition of when an agency is deemed to have received a proper invoice. We suggest this change because not all bills are sent directly to points within the agency.

For example, the Department of Housing and Urban Development (HUD) has designated local real estate companies to manage HUD-owned properties. They arrange for repairs, accept resulting work as satisfactory, and receive invoices for work performed. These HUD agents forward the invoices to the appropriate HUD office for final approval and subsequent payment directly to the contractors who performed the work. As we stated in our August 1986 report, in some instances, a HUD payment center improperly calculated payment due dates by basing them on when the HUD office received the invoices from the real estate companies, rather than on when the companies initially received the invoices from the vendors. Several payment centers from other agencies followed similar practices.

In effect, ignoring the date an invoice is received at the location the vendor was told to send it to may frequently allow agencies more time to pay--without being subject to an interest penalty. We believe that the basic intent of existing law is to require the government to generally pay within a period of no more than 30 days, regardless of whether intermediaries are involved in the payment process.

Finally, we want to point out that late payments caused by agency activities accepting goods or services were often not the result of slow acceptance, but rather of not promptly forwarding receiving/acceptance reports to the payment centers. Without adequate internal controls to ensure that accepting activities forward such documents promptly, these modifications may not significantly decrease the number of late payments. In fact, without improving needed controls, adopting such a provision will increase the percentage of payments requiring interest penalties. To this end, we recommended in our report that OMB direct agencies to ensure that acceptance documents are forwarded to the appropriate payment center within the short time frame established by OMB for accomplishing this task.

Eliminating Grace Periods

Section 4(a)(1) would initially reduce and subsequently eliminate the current 15-day grace period during which an agency may pay a bill late without incurring any interest penalties. Grace periods for meat and perishable agricultural products would also be eliminated. In our view, eliminating grace periods may increase the government's administrative costs for paying commercial bills and could result in further delays for some payments. Thus, we believe it would be appropriate to retain a grace period. However, based on the results of our review, we do not see any compelling reasons why the current 15-day grace period could not be shortened to 10 or possibly 7 days.

We found that about 15 percent of payments occurred during grace periods. However, we did not find any intentional abuse such as agencies routinely paying as closely as possible to the end of such periods. Instead, most grace-period payments were made within 5 days after the due date.

Eliminating the grace period entirely could increase administrative costs, especially for civil agencies which do not issue their own checks. Instead, they send a listing or schedule of approved payments to one of seven Department of the Treasury disbursement centers which are to issue the checks on the date requested by the agency. Agency officials noted that delivery time to the Treasury--mostly by mail--fluctuates considerably and, therefore, is not always predictable. Also, processing time by Treasury can take somewhat longer than anticipated.

Such events, which are not under the control of an agency, may result in payments which are made a few days after the due date because agency payment centers, in the interest of efficiency and for reasons explained below, generally attempt to send the Treasury only one schedule of payments due on a particular day. To ensure that all payments due on that day are included, payment centers generally do not finalize and forward such schedules of approved payments until about 5 days before the due date. This is necessary because documentation needed to ensure that the payments are valid and proper (such as contracts, invoices, and receiving and accepting reports), frequently does not arrive at the payment center until just before the due date. Forwarding the schedules earlier would almost certainly require that one or more additional schedules be prepared for the same day.

In most instances, these additional, or possibly all, schedules would have to be prepared manually because

(1) Treasury's check issuance process dictates that all payments recorded on a payment schedule have the same due date and (2) in the interest of efficiency, Treasury wants payment schedules recorded on magnetic tape to include at least 100 payments. Consequently, hundreds of low-volume payment centers generally must consolidate all or most of their payments due on the same date on one schedule if they want to avail themselves of an automated payment process. As noted in an earlier GAO report on duplicate payments[4], manually preparing payment schedules reduces the productivity of a payment center and, more importantly, increases the risk of making duplicate payments because manually processed payments bypass certain critical automated systems checks and edits.

Eliminating grace periods could also create another type of payment delay. Treasury, when noting that checks could not be issued by due dates, would have to return the particular payment schedules to the respective agencies to obtain authorizations to pay the required late payment penalties. This would become particularly important if the double interest penalty provision included in this bill became law. However, returning the schedules would delay these payments even further and add more administrative costs to both the Treasury and the agencies.

Finally, eliminating grace periods could encourage agencies to make payments well before they are due in order to avoid incurring interest penalties. Obviously, this would benefit vendors. However, in terms of the dollar effect, our estimates show that increased federal interest costs attributable to early payments far exceed the amounts of penalties owed to vendors because of late payments. We do not believe that action should be taken that could possibly lead to further increases in such costs. Thus, while it may be appropriate to shorten the length of the current 15-day grace period to 10 or possibly 7 days, we do not believe that such periods should be eliminated.

Charging Late Payment Penalties

Section 4(b) would require agencies to voluntarily pay interest penalties in excess of $1. OMB Circular A-125 currently requires agencies to pay interest penalties without waiting for vendors to file claims with the exception that "Interest penalties of less than one dollar need not be paid." Thus, this section of the bill establishes a slightly different threshold for paying interest than the circular does. It would require voluntary payment of interest penalties which exceed one dollar while the circular requires voluntary payment of penalties which exceed 99 cents.

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[4] General Services Administration Needs To Improve Its Internal Controls To Prevent Duplicate Payments (GAO/AFMD-85-70, August 20, 1985).

A more important difference is that the OMB circular states that amounts below the threshold of $1 need not be paid, while the bill's language could be interpreted to mean that if a specific request for payment of interest is received, even such nominal amounts would have to be paid. We suggest modifying the bill's language regarding the threshold for paying interest to be consistent with the OMB circular. A major reason for our suggestion is that agency systems are already designed to consider this threshold. Thus, we believe that disruptions in current procedures and agency system redesign costs for such a small difference should be avoided. If the objective is that nominal amounts of $1 and less should be paid under certain circumstances, we suggest that language in the bill be more explicit on this point.

Section 4(b) also would require agencies to pay double interest penalties if they fail to automatically pay any penalties due and if the contractor makes a written demand that such penalties be paid. We are not aware of any similar practices in the commercial sector. Therefore, adoption of such a provision would impose more stringent requirements on the government than is customary in the private sector. However, we agree that agencies should voluntarily pay any penalties due.

As noted in our August 1986 report, interest penalties were often not paid. Although some payments may have been purposely withheld, many were not made because of poor internal controls. These internal control problems included occasional disregarding of contractual payment timing terms by payment technicians, or combining of several invoices for payment without carefully considering when they were due. Improvements in these and other areas that were recommended in our August 1986 report could increase the percentage of on-time payments as well as help assure that penalties are paid as required. At this point, we cannot estimate whether a requirement for doubling of unpaid penalties would significantly increase the total dollar value of penalties paid.

Construction Contracts

The intent of section 5 of the proposed bill appears to be to clarify that progress payments under construction contracts are subject to the Prompt Payment Act's requirements, such as establishing when they are due and including an interest penalty if they are made late. DOD currently excludes such payments from all prompt payment requirements, while other agencies do not pay interest penalties on late payments of this type. To preclude possible other misinterpretations, it may be desirable to indicate whether the term "construction"--as used in this section and in section 10(b)(1)(C)--refers to erecting buildings only, or has a broader meaning that would include activities such as ship building. Without taking a position on the merits of section 5, we believe that if such a provision is retained in the bill, it should cover all progress payments regardless of the type of activity involved.

Providing for Periodic Payments Under Supply and Service Contracts

Section 6 and section 10(b)(2) would provide for periodic payments for supplies or services based on either acceptance of or certification that goods or services are satisfactory and on receipt of an invoice. Existing language in the Prompt Payment Act does not require that vendors submit invoices for all periodic payments and OMB has recognized this in its implementing regulation.

GSA, and possibly other agencies, currently pays for some services, like leases, without requiring vendors to submit invoices at monthly or other intervals. Instead, payment systems are programmed to automatically pay at prescribed intervals. This is possible because the amount of the periodic payments, set by contract, remains constant for some time. Not requiring invoices and automating the payment process help ensure timely payments and reduce administrative costs. We suggest that the bill be modified to avoid requiring invoices in circumstances where they are not necessary to insure good internal controls over disbursements.

Defining the Discount Period

Section 8 would define the beginning of any offered discount period as the date the designated agency office or employee first receives the invoice. (Earlier we suggested the receiving point for the invoice be redesignated as "place or person.") Although this provision does not seem to allow use of other discount terms, section 10(b)(4) of the bill states that agencies may take discounts only in accordance with time limits established by a vendor. To resolve this apparent conflicting guidance, section 8 of the bill could be modified to provide that those terms apply only if neither the contract nor the invoice explicitly identifies the period during which a discount may be properly taken.

Much of the confusion surrounding discount periods could be solved if agency procurement personnel would ensure that discount terms are consistently included in procurement contracts. As a general rule, we favor using a standard discount period largely because we found that varying payment terms were one of the primary causes of improperly taken discounts. Based on our work, we believe that it would be preferable to use the starting-date rules already established in the FAR rather than the terms currently stated in the bill. The FAR terms are equitable to vendors because they establish the start of discount periods as the later of receipt of the invoice or delivery of goods or services, both of which are events under the control of vendors. We also favor retaining this criteria because it ensures agencies an opportunity to inspect the goods or services before the end of the discount period.

Nevertheless, if a contractor can convince an agency that it would be advantageous to the government to agree to and specify different discount terms in the contract, or independently offers more advantageous terms in the invoice, we think the agency should have the authority to avail itself of such terms.

Providing Greater Detail in Annual Reports

Section 9 would require agencies to include in their annual reports to OMB information on invoices paid after the due date which did not include interest penalties. We generally agree with the proposed change but, as noted below, would suggest minor refinements.

We pointed out in our August 1986 report that agencies interpreted the term "payments" differently and that this resulted in inconsistent reporting and possibly contributed to OMB's overstatement of payment-timing performance data. Some agencies reported on the basis of the number of invoices for which they had paid interest penalties, while others reported based on the number of checks issued--which on occasion cover multiple invoices--that included penalties. We also noted that some contracts for utilities call for prescribed late payment penalties rather than interest when utility bills are paid late. Some agencies did not report such late payment penalties because the Prompt Payment Act and OMB's Circular A-125 call for reporting interest penalties.

To ensure consistent and comprehensive reporting, we recommended that OMB define the term "payment" when used for reporting purposes to mean invoices and to modify Circular A-125 to require reporting of both interest penalties and other kinds of late payment charges. OMB has agreed with our recommendations and used the suggested language in its November 13, 1986, memo calling for fiscal year 1986 payment-timing information from individual agencies. OMB is currently in the process of incorporating the suggested language in its prompt payment-related regulations.

Accordingly, we suggest that parts A and B of section 9 of this bill be revised to read as follows:

> "(A) the number, dollar value, and frequency of invoices for which interest or other late payment penalties were paid, the amount of such late payment interest and penalties, and the reasons . . . ."
>
> "(B) the number, dollar value, and frequency of invoices paid after the required payment date without payment of an interest or other late payment penalty, and . . . ."

Implementation Through the Federal Acquisition Regulation

Section 10 of the bill would require the government to develop solicitation and contract clauses for the FAR that allow contracting officers to establish varying due-date terms depending on the nature of the products being purchased. We strongly agree that the FAR should contain due-date provisions and we understand that, considering the wide range of goods and services agencies procure, some flexibility in setting due dates is needed. However, we caution that the bill, as currently worded, may result in a wide variety of payment periods. This increases the risk of errors in determining when payments must be made.

As noted earlier, we found that one of the primary causes of late payments was the lack of simple, uniform payment terms. We believe that payment performance can be substantially improved by requiring agencies to use standard clauses, including specified payment periods, in contracts. In our opinion, this would reduce the potential for errors in calculating payment due dates, decrease administrative workloads at payment centers, and improve overall payment performance. We recognize that it may be appropriate to use different payment criteria for items that require more extensive testing before accepting them as satisfactory. However, if most payments are to be scheduled correctly and efficiently, exceptions should be held to a minimum.

Section 10(b)(1)(C) would give agency contracting officers the authority to include in construction contracts a provision that progress payments be made within 7 days, unless the prevailing practice in private construction contracts requires a longer payment period. Because of the billions of dollars involved in construction projects annually, the likely diversity among such projects, and the fact that some agencies need a week to process a payment (this includes obtaining and reviewing documentation and forwarding payment schedules to the Treasury for check issuance), it may not be appropriate to use such a short payment period for these types of payments.

Finally, purely from an economic standpoint, even small shifts in payment timing can change federal interest costs by millions annually. Unless assurance exists that the government receives adequate compensation, such as reduced prices for earlier payments, paying too quickly can increase overall federal costs. As recommended in our August 1986 report, we believe that OMB and the principal agencies responsible for awarding such contracts should assess what the most advantageous payment period within the restraints of existing legislation would be. During these deliberations, the agencies should consider the effect that shorter or longer payment terms would have on the level of competition for such federal procurements. Regardless of the ultimate decision, contract clauses that result in specific payment due dates should be developed and used consistently.

Other Considerations

One other factor merits consideration for change while the Congress proceeds with amending the Prompt Payment Act. Provisions in that legislation call for calculating payment due dates for purchases of meat and perishable agricultural products based solely on the product delivery date. Applying this criteria, we found that interest penalties were due on some payments for which vendors had not yet submitted invoices. We believe agencies should not have to choose between paying interest penalties and observing good internal controls which would normally call for receiving an invoice prior to payment. One such internal control feature would be to use invoice numbers as one element in preventing duplicate payments. This situation could be remedied by adding invoice receipt dates to existing criteria for calculating payment due dates for these types of products. Thus, the specified payment period would commence on the date a proper invoice was received at the designated location, or on the date the products were delivered, whichever is later.

GAO
United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

April 7, 1987

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Mr. Chairman:

In response to a March 26, 1987, request from Senator Jim Sasser, we are providing answers to three questions to be included in the printed record of hearings your committee held on March 19, 1987, on S. 328, the "Prompt Payment Act Amendments of 1987."

We are providing our answers to the questions given to us in an enclosure. We hope that our views will be helpful during your deliberations. If your committee should need any additional assistance, please contact Mel Mench on 275-9486.

Sincerely yours,

Jeffrey C. Steinhoff
Associate Director

Enclosure

ELIMINATING GRACE PERIODS

"The statement of all of the witnesses from the contractor community have called for elimination of the 'grace periods.' S. 328 calls for their gradual elimination. Your comments on the bill suggest that there may be some problems that the Committee hasn't fully considered."

Question

"Please share with the Committee your views with regard to elimination of the 15-day 'grace period.'"

Answer

We fully support shortening the grace period to 7 days as provided for in section 4(a)(1) of the bill. However, we see merit in keeping some such interest-free period at this time. We have some concern that eliminating the grace period entirely could increase the government's administrative costs for paying commercial bills and could result in further delays for some payments.

Primarily, this is because most civil agencies do not issue their own checks. Instead, the Department of the Treasury prepares checks or makes electronic fund transfers for them based on agency payment requests. Mailing time to, and processing time at, Treasury cannot be precisely predicted by the agencies. Consequently, civil agencies do not have absolute control over when payments are made, and, as a result, some could be made a few days after they are due.

Because Treasury has neither the data necessary to determine precisely how late a payment may be nor the authority to unilaterally add interest penalties to a late payment, Treasury would need to return a delayed payment request to the respective agency to obtain authorization to pay the required penalty. This would become particularly important if the double interest penalty provision in this bill were to become law. However, returning the request would delay these payments even further and result in greater administrative costs for both Treasury and the agencies.

Theoretically, to avoid late payments, agencies should mail payment requests to Treasury far in advance of the due date. However, this is often not possible because many parts of current payment systems are manual and require repeated handling of paper documents. The documentation needed to ensure that payments are valid and proper (such as contracts, invoices, and receiving and accepting reports) frequently originates at distant locations and does not arrive at agency payment centers until just before the due date.

In addition, in the interest of efficiency, Treasury wants payment requests that are recorded on magnetic tape to include at least 100 payments, and all checks for payments recorded on one request will be issued on the same day. Because of this, agencies generally do not finalize and forward payment requests until about 5 days before the due date. Forwarding them earlier would almost certainly require that one or more additional requests be prepared for payments due on the same day.

In most instances, these additional requests would have to be prepared manually. However, manually preparing payment requests increases the risk of making duplicate payments because manual payments bypass certain checks and edits within automated systems. Furthermore, manual preparation reduces the productivity of a payment center.

When the Prompt Payment Act was passed in 1982, short delays in payment were not the issue. Instead, contractors and their representatives pointed out that the problem was with payments that were delayed for 3 or 4 months or even longer. Although we found that about 15 percent of commercial payments occurred during grace periods, we did not find any intentional abuse, such as agencies routinely paying as closely as possible to the end of such periods. Instead, 60 percent of grace-period payments were made within 5 days after the due date and another 25 percent occurred within the next 5 days. Considering current federal payment systems, we believe there is merit in retaining a short grace period.

DOUBLING INTEREST PENALTIES

"S. 328 includes a provision designed to act as a deterrent to government officials who might be tempted to avoid the payment of an interest penalty due to a contractor. It provides for doubling of the penalty if the conditions specified in the amendment are met."

Question

"Please share with the Committee your views concerning this provision."

Answer

Doubling interest penalties under certain circumstances would be another strong incentive for agencies to improve their payment-timing performance. It may also make them more sensitive to paying penalties when called for, an area where improvement is needed.

In our August 1986 report Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits (GAO/AFMD-86-69), we noted that agencies had paid only one of every six late penalties identified as due in our sample. Some of these may have been purposely withheld, but most resulted from inadequate administrative controls. These internal control problems included occasional disregarding of contractual payment-timing terms by payment clerks or combining several invoices for payment without carefully considering when individual payments were due. The possibility of double penalties may be an incentive to payment center managers to make improvement of administrative controls a higher priority.

At this point, we cannot estimate whether a requirement to double unpaid penalties would significantly increase the total dollar amount of penalties paid. Also, we are not aware of any similar practices in the private sector.

PAYING SUBCONTRACTORS PROMPTLY

"Section 7 of S. 328 would establish minimum standards for the payment provisions to be included in construction subcontract agreements, so that construction subcontractors will be afforded the minimal protections of the Prompt Payment Act within the "four corners" of their subcontract agreements. Opponents of section 7 argue that the government does not have a legitimate stake in timely payments between the prime contractor and the subcontractor."

Question

"Would you share with the Committee your views?"

Answer

Section 7 of the bill would, in effect, require contractors working on federal construction projects to pay their subcontractors promptly. Delays would result in late payment penalties similar to those that agencies are liable for on late payments to a prime contractor.

As discussed in our August 1986 report, the objective of our recent audit of federal bill payment performance was to determine whether agencies made timely payments to firms directly involved in providing goods and services to the government. We do not have data to show how long subcontractors have to wait for their money, if there is a problem, or how widespread the problem may be. Therefore, we cannot comment on the need for this provision. Ultimately, we see this issue as a matter for the Congress' determination but offer some observations for your consideration.

The Prompt Payment Act was intended to afford contractors a new, previously unavailable remedy against the federal government for payment delays. Prior to passage of the act, the government could be held liable for interest on late payments to a prime contractor only if the contract so specified. Negotiating inclusion of adequate interest provisions could be difficult, and enforcement was often impractical. Without an interest provision in the contract, the doctrine of sovereign immunity precluded the government from being held liable for interest. Thus, contractors were often not reimbursed for the "time value" of the government's delays in payment.

In passing the Prompt Payment Act, the Congress had two basic concerns. First, it recognized that, as a result of the government's bill paying practices, competition on government procurements might be limited and that contractors who continued to deal with the government could be passing the cost of payment delays back to the government in the form of higher prices. Second, the Congress did not believe it was equitable for the government to demand that its debtors pay interest on past due amounts, yet simultaneously to refuse--based on sovereign immunity--to pay interest to its creditors. The Congress concluded that neither of these problems could be resolved without legislation.

While the Prompt Payment Act currently addresses the government's dealings with the private sector, section 7 of S. 328 would set forth bill payment practices affecting the private relationship of the contractor and subcontractor. Because there is no direct relationship between the government and a subcontractor ("privity"), the government is not liable to a subcontractor for late payment, or even nonpayment, by the prime contractor. We realize that section 7 is not intended to alter this situation, but there are several issues that the Congress will have to consider if it proceeds with this provision.

Although it would seem fair that the same principles embodied in the Prompt Payment Act should also exist between contractors and their subcontractors, you may wish to consider whether a statute dealing with government liability is the most appropriate vehicle for addressing payment delays between private parties. Also, under the common law, subcontractors may seek interest penalties from the prime contractor through the courts to compensate for losses attributable to past due payments. Finally, you may wish to consider whether section 7 should apply only to construction subcontractors.

If the committee decides to retain section 7, we suggest that it be modified to make clear that it is not intended to obligate the contractor to pay disputed amounts or late payment penalties which might otherwise accrue on amounts which are withheld as the result of a legitimate dispute. The Prompt Payment Act already contains a similar provision to govern penalty assessments on amounts withheld by the government under such circumstances.

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National Federation of
Independent Business

NFIB

STATEMENT OF

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Committee on Government Affairs
Subject: Prompt Payment Act Amendments of 1987, S. 328
Date: March 19, 1987

Mr. Chairman, the National Federation of Independent Business, on behalf of its over half million members, appreciates having this opportunity to testify today on S. 328, the Prompt Payment Act Amendments of 1987. We also welcome the chance to comment on the implementation of the original Prompt Payment Act and why amendments to it are needed.

Before I begin, I would like to take this opportunity to thank Senator Sasser, Senator Trible, and the Senate Small Business Committee for their continuing interest in, and fine oversight of, the Prompt Payment Act, P.L. 97-177. The Small Business Committee's hearings in Norfolk, Virginia and in Washington last year set the stage for today's session and for what I hope will be rapid enactment of S. 328. Now is the time to clarify the Congressional intent of certain aspects of the basic statute and to close some administra- tive loopholes which have been discovered. We at NFIB are particularly encouraged by this Committee's expeditious handling of the issue so soon into the 100th Congress.

Today, government contractors of all sizes report obvious improvements in the payment process since enactment of the Prompt Payment Act in 1982. Before passage of P.L. 97-177, only sixty-one percent of the government's bills were paid within thirty days. According to OMB, that record has improved to ninety-nine percent. In 1983, a total of $2.9 million in interest penalties were paid out. That represents 180,000 late payments out of twenty-three million payments. The Defense Department is the biggest offender, accounting for sixty percent of those late payments. With these interest charges coming directly out of the administrative funds for each agency, we have been able to provide the correct incentive for timely processing of invoices. The result has been improved agency implementation of the law each year.

I wish that I could say that NFIB no longer receives complaints from its members on the government's payment process. However, we continue to hear from our members about spotty implementation of the Act. In many cases, late payments alone have deterred small firms from doing business with the government. We think the government suffers when this happens: it is denied access to the most competitive, innovative sector of our economy for its needed goods and services. We feel strongly that there is no justifiable reason for delaying payment to a contractor who has fulfilled his or her contractual obligations and has submitted a proper invoice.

Our specific concerns with the current payment process and our comments on the specific language of S. 328 follow.

RECEIPT OF PROPER INVOICE

Without a doubt the single most abused and ambiguous section of the current law relates to government "receipt" of a "proper" invoice. The date on which the designated payment office or finance center of the agency actually receives a proper invoice is the date the clock begins to tick in the payment process. Interest penalties begin accruing thirty days from that date, but frequently one to three months pass before an invoice works its way through the paperwork channels and officially reaches a "payment center". This internal flow of paperwork is beyond the control of the contractor. So while agencies report a ninety-nine percent on-time payment record, this does not accurately reflect the situation from the contractor's point of view. There often continues to be a lengthy lag time before an invoice is considered "received" by the appropriate payment office. These delays in the "formal" receipt of any invoice have caused delays of thirty to ninety days or more.

Several NFIB members have written to complain about signed invoices being "lost" by the contracting officer. A concrete company owner wrote us in March of 1986 about work she had successfully completed for the Navy during August and September of the preceding year. The project was inspected in October and certified. The project manager indicated that he had "lost" the invoice and requested they begin the billing process all over again five months later. It is often the vendor's word versus the agency official's word that the invoice was ever received. Many business people are hesitant to challenge the word of the contracting officer, especially if they want to do business with that official in the future.

Section 3 of S. 328 much more clearly and tightly nails down the starting point of the payment clock by amending the law to read:

> "the head of an agency is deemed to receive an invoice on the later of: A) the date on which the office or employee of the agency designated by the agency to first receive such invoice actually receives a proper invoice; or B) on the fifth day after the date on which ...the property is actually delivered or final performance of the services is actually completed,... unless the contract specifies a longer period for agency acceptance."

Small businesses cannot afford to carry any customer for an indefinite period of time, even if it is the U.S. government. The time between delivery of their product and receipt of their invoice by the accountable agency official is now often a guessing game which our members cannot afford to play. We believe the language of Section 3 will go a long way toward shortening the paperwork trail invoices now follow before they officially arrive, and it should also reduce the chances for lost paperwork thereby. However, we would recommend the addition of a requirement that any notice of incomplete or incorrect invoices include a name or telephone number for the contractor to contact. We have heard so many stories of "bureaucratic runaround" or "telephone handoff" that we believe this addition would solve many of the public's current problems.

PHASING OUT THE GRACE PERIOD

During the final negotiations on the original Prompt Pay Act, the Administration was successful in persuading the Congress that it needed some time to implement the changes in the payment process mandated by the Act. The Administration was able to get the Congress to accept a fifteen-day "grace period" in addition to the initial thirty days to process their payments. This means that if payment is made within the "grace period", there is no interest paid. If payment is not made by the forty-fifth day, interest accrues from the thirty-first day. In practice, this has allowed the government forty-five days to pay its bills rather than the intended commercial norm of thirty days.

NFIB considers government directives that advise finance officers to use the entire forty-five day period before issuing payment an abuse of the spirit, if not the letter, of the law. Our small business members are not given a "grace period" by their creditors or by the IRS, which demands prompt payment on their accounts. For just these very reasons, one NFIB member commented to us that "the 'grace period' galls [him] more than anything else".

Most of the states that have passed similar prompt pay legislation either do not include a "grace period" at all or have a period that phases out after a certain number of years.

The government has had four years to make the necessary adjustments in their payment procedures. Now is the time to begin eliminating the "grace period". We congratulate Sen. Sasser for recognizing the abuses inherent in this section of the law and for phasing out the "grace period". His bill reduces to seven days the length of this period through October 1, 1990, then eliminates it entirely. We would just as soon see the grace period end upon enactment of S. 328, or at worst, by October 1, 1988.

LIMITATIONS ON DISCOUNT PAYMENTS

In no other step of the government's payment process is the potential for saving millions of dollars more obvious than in the "fast pay" discount offered by most vendors. In an effort to get paid quickly, contractors will offer the government a discount (two to three percent) if they are paid in ten to fifteen days. Discount payments are offered as an reward for prompt paying customers, but are being abused by the government. We often wonder why more agencies don't use this opportunity to save taxpayer dollars rather than abusing the fifteen-day "grace period." Some agencies have decided to do both. They continue to take the discount after the prescribed period has expired. Not only is the vendor not getting paid on time; he or she is not getting complete payment.

Although the law specifically prohibits this practice, we continue to hear from our members that this is a problem. We are glad to see language in S. 328 to strengthen and clarify this section of the statute.

AUTOMATIC PAYMENT OF INTEREST

NFIB has been disappointed to see some agencies requiring contractors to make written demands for interest fees legitimately due them. Sen. Sasser's bill clarifies that interest payments exceeding $1.00 shall be automatically paid to the vendor. As a further incentive to the procuring agency to keep up with these late fees, a contractor will be eligible for twice the interest penalty due him or her if ten days expire following the payment date and no late fee has been received. Vendors would have to put these demands in writing to kick in the double penalty, but the government will have to pay for their laxity.

PROGRESS PAYMENTS AND RETAINAGE

Both House and Senate Committee reports that accompanied P.L. 97-177, as well as the law itself, dealt with interest penalties on progress payments and retainage. Specifically, House Report 97-461 states:

> "To the extent that contracts involving a series of partial payments or executions provide for separate payments, OMB's regulations shall specify separate dates when payment is due. This provision is intended to cover situations where the government and a business concern contract for separate payment for partial deliveries or executions; for example, progress payments."

The Congress could not have been clearer in its intent in such cases. Yet we continue to receive complaints from members, especially in the construction field, that progress payments are not subject to the Prompt Payment Act. One member was awarded a contract to build a main post office building in California in September of 1985. Work began shortly thereafter. As of April of 1986, they had yet to receive any progress payments from the government.

NFIB believes the government should behave like any other customer: if they are in receipt of partial deliveries or partial contract execution, they should make partial payments. We were very disappointed, therefore, in OMB's position on this matter as reflected in OMB Circular A-125. We feel their interpretation contradicts the law and excludes progress payments from this Act. While we were glad to see S. 328 address this problem, we would prefer the clarification not be limited to construction contracts. The current law makes no distinction, and we would prefer to keep it that way.

The problem of retainage is another matter, however. While representatives from the construction industry can address this issue in greater detail, let me say that NFIB agrees that retainage on progress payments should be limited to very specific, extraordinary circumstances. Where retainage is used, interest on that retained amount should be paid if held beyond the required payment date. Therefore, we support the language of Section 5 dealing with retainage.

PROMPT PAY FOR SUBCONTRACTORS

Another issue that concerns NFIB members is the processing of payments to subcontractors on government contracts. The Prompt Payment Act is silent in this regard, yet we have file folders full of complaints to prove that it is a serious problem. The Small Business Committee acknowledged this problem when it included a policy statement in the Small Business and Federal Procurement Competition Enhancement Act (P.L.98-577) encouraging prime contractors to adopt procedures to provide timely payment to their subcontractors.

One member in Redding, California described the following scenario:

"We install heating and air-conditioning systems in commercial and residential buildings. Most of our work is done as sub-contractors for a general contractor....The problem is, it seems to take anywhere from forty-five to ninety days from the date of our billing to get payment. By that time, we could be almost done with our job and only have received payment for twenty percent of the contract. Meanwhile our payroll costs continue and our suppliers are charging us late charges....This really hurts the last guy in line, who ends up having to pay all his profits for penalties and interest on supplies, loans, government payroll withholdings, benefits, etc."

Another member in Ashland, Virginia told us he had done some sheet metal work for a contractor on a HUD project over five months earlier and still had not received payment from the general contractor.

A supplier in Manassas Park, Virginia had done some work at Dulles Airport for a general contractor. While the general contractor had been paid for seventy percent of the project, our member had received none of the money due him.

Although a part of the government payment process, these subcontractors have no recourse under the Act for late payments on overdue bills. NFIB therefore fully supports the provisions of Section 7 of the bill which extend the coverage of the Prompt Payment Act to subcontractors under federal construction contracts. We would, however, go further than the bill's extension of coverage by including all contracts, not just construction contracts, and by including subcontractors of subcontractors. We believe that the principles of the Prompt Payment Act should apply to all government payments and to everyone involved in the chain of those payments -- noone should be left holding the bag at the end of the Prompt Pay Act's coverage.

Prime contractors very often serve as project managers, performing very little of the actual work with in-house resources, but rather coordinating and overseeing the work of multiple subcontractors. As such they are the funnel through which government payments must pass. We see no reason to allow the primes off the hook if they become the payment bottleneck -- and we say this as an organization representing both prime contractors and subcontractors.

In closing let me say that NFIB believes the government should be held accountable for all its payments. While tremendous progress has been made in this area, we would suggest that the government needs to be more conscientious about their payment performance. NFIB supports S. 328 as it is before the Committee, but would suggest the minor additions noted above. Let me once again thank the Committee and Senator Sasser for giving this matter their attention and for letting NFIB have this opportunity to share our views with you.

0271T/mkb

4

Quality & Service since 1907

BANKS-DORGAN COMPANY

T/A Birshtein Studios

2400 FLORIDA AVENUE
NORFOLK, VIRGINIA 23513

INVOICE

Nº 10047

10047

AREA CODE 804 · PHONE 853-4333

PO: N00189-86-M-AB37
REQN: AS LISTED

SOLD TO
Supply Officer
USS Iowa (BB-61)
FPO New York, N.Y. 09546-1100

SHIP TO
CONT'D FROM PAGE 1
[illegible]

DATE OF INV	PURCHASE ORDER NO	CUSTOMER	F.O.B.	CHARGE	ORDERED BY	SHIPPED VIA
[illegible]/13/86	Above	USS Iowa (BB-61)		XXX	M. Weathers	Our Truck/installation

QUANTITY	UNIT	ITEM	DESCRIPTION	UNIT PRICE	AMOUNT
1	Lot	Curtain. Fibrous glass Per Fed. Spec. CCC-C-00703, Type C. Provide labor and materials to manufacture and install approx. 25 Lin. Ft. including new rodding. REQN: V05051-6037-3194		797.00	797.00
	Lot	Curtain see Item 7, except approx. 12.5 Lin. Ft. REQN: V05051-6037-3194		[illegible].00	44[illegible].00
1	Ea.	C of C			N/C

SUBTOTAL		
SALES TAX		
DELIVERY CHARGE		
TOTAL		5,25[illegible].15

RECEIVED, INSPECTED & ACCEPTED BY (SIGNATURE)

DATE

NAME & RATING (PRINT)

PAGE 2 OF 2
Net 30

TERMS NET E O M

SELLER MAY AT HIS DISCRETION CHARGE THE MAXIMUM LEGAL INTEREST RATE ALLOWED ON INVOICES PAST DUE 30 DAYS OR LONGER.
BUYER FURTHER AGREES THAT IF THIS MATTER MUST BE FORWARDED TO AN ATTORNEY FOR COLLECTION, SAID BUYER SHALL BE RESPONSIBLE FOR ALL COSTS OF COLLECTION, INCLUDING A REASONABLE ATTORNEY'S FEE.

EXAMINE THESE GOODS BEFORE CUTTING
NO CLAIMS ALLOWED AFTER MERCHANDISE HAS BEEN CUT

Quality & Service since 1907

BANKS-DORGAN COMPANY

T/A Birshtein Studios

2400 FLORIDA AVENUE
NORFOLK, VIRGINIA 23513

INVOICE

№ 10046
10046

AREA CODE 804 - PHONE 853-4333

PO: N00189-86-M-A537
REQN: AS LISTED

SOLD TO
Supply Officer
USS Iowa (BB-61)
FPO New York, N.Y. 09546-1100

SHIP TO
SERVICE FOR:
Supply Officer
USS Iowa (BB-61);

DATE OF INV	PURCHASE ORDER NO	CUSTOMER	C.O.D.	CHARGE	ORDERED BY	SHIPPED VIA
~~[illegible]~~	~~[illegible]~~	USS Iowa (BB-61)		XXX	M. Werthers	Our Truck/Installation

QUANTITY	UNIT	ITEM / DESCRIPTION	UNIT PRICE	AMOUNT
7	Ea.	Flat Table Covers 51"w x 118" Provide labor and materials to manufacture table covers. REQN: V03061-6057-3188	32.00	224.00
7	Ea.	Fitted Table Covers 36" x 96" x 4' Drop REQN. V03061-6062-3283	39.86	279.02
7	Ea.	Flat Table Cover 51" x 130" or fitted table cover 36" x 112" x 4' Drop as per selection. REQN: V03061-6057-3189	33.43	234.01
1	Ea.	Flat Table cover 51" x 168" or fitted table cover 51" x 43" x 4' drop as per selection. REQN: V03061-6057-3190	40.00	40.00
44	Ea.	Wardroom area chair covers, except one CPO emblem printed on back of chair. REQN. V03061-6057-3191	28.98	1,275.12
1	Lot	Carpet Per Fed. Spec. DDD-C-95, Type II, Class 2 (USN Shipboard approved) Remove existing carpet patch underlay, install new carpet in lounge area. REQN: V03061-6057-3192	1,990.00	1,990.00

SUBTOTAL		4,042.15
SALES TAX		
DELIVERY CHARGE		
TOTAL		CONT'D

RECEIVED, INSPECTED & ACCEPTED BY (SIGNATURE)

DATE

NAME & RATING (PRINT)

PAGE 1 OF 2

TERMS NET E.O.M.

SELLER MAY AT HIS DISCRETION, CHARGE THE MAXIMUM LEGAL INTEREST RATE ALLOWED ON INVOICES PAST DUE 30 DAYS OR LONGER.

BUYER FURTHER AGREES THAT IF THIS MATTER MUST BE FORWARDED TO AN ATTORNEY FOR COLLECTION, SAID BUYER SHALL BE RESPONSIBLE FOR ALL COSTS OF COLLECTION, INCLUDING A REASONABLE ATTORNEY'S FEE.

EXAMINE THESE GOODS BEFORE CUTTING
NO CLAIMS ALLOWED AFTER MERCHANDISE HAS BEEN CUT

Should have rec'd pay by end of July 86

① 8-13-86 Called Iowa
444-7130 Quarterdeck
444-4101 Supply
444-4108 SK3 Moon
will call back

② 8-19-86 Called SK3
Moon - @ 444-4108 + 444-4101
+ 444-7130 no answer

BANKS-DORGAN COMPANY
2400 FLORIDA AVENUE · AREA CODE 804 PHONE 853-4333
NORFOLK, VIRGINIA 23513
Quality & Service since 1907
USN SHIPBOARD HABITABILITY ITEMS

JOBBERS
GOVT SPEC INDUSTRIAL
FABRICS PLAIN & COATED FILTER MATERIALS

WHOLESALE DISTRIBUTORS
UPHOLSTERY – DRAPERY – SLIPCOVER FABRICS,
VINYLS, & SUPPLIES CANING ITEMS

August 28, 1986

Commander Naval Surface Force
U.S. Atlantic Fleet
Code N711
Norfolk, Virginia 23511

Dear Chief Agustin:

Listed below are more invoices I need assistance with. Any help you can give will be greatly appreciated.

(1) PO: N00189-86-M-A537
REQN; V03061-6057-3188, V03061-6062-3283, V03061-6057-3189,
V03061-6057-3190, V03061-6057-3191, V03061-6057-3192
V03061-6057-3194, V03061-6057-3194
Inv.# 10046&10047 Dated 6/13/86 $5,288.15

Sublant

(2) PO: N00189-86-M-T510
REQN: V20635-6135-5R50
Inv.# 10022, Dated 6/6/86, $689.70

(3) PO: N00189-86-M-A676
REQN: V52234-6098-2005, V52234-6098-2007, V52234-6098-2008
V52234-6098-5010, V52[illegible]4-6098-2011
Inv.# 10078, Dated 6/[illegible]1/86, $6,521.00

Thanking you in advance for your help.

Yours truly,

Nancy S. Hunt

WESTERN UNION C.R.C.
4CEB DRAWER 38
ALBANY GA 31704 09AM

Western Union Mailgram

4-000106A252 09/09/86 ICS DIWCRSA ABN NFKD
00704 DIW CRC ALBANY GA 904552 SEP 86/252

rec'd 9-9-86

BANKS DORGAN C
2400 FLORIDA AVE
NORFOLK VA 23513

4

T R RUCBSGG1332 2520346 NA-CNRF
R 082327Z SEP 86 ZYB
FM COMNAVSURFLANT NORFOLK VA
TO RHCFMGG/USS IOWA
INFO RULYMPA/COMCRUDESGRU EIGHT
RUCUSAA/FAADCLANT NORFOLK VA
RUCLRFA/BANKS DORGAN CO
2400 FLORIDA AVE
NORFOLK VA 23513
ACCT NA-CNRF
UNCLAS //N07200//
SUBJ: UNPAID INVOICE FM BANKS DORGAN CO
A. BANKS DORGAN CO LTR DTD 28 AUG 86 (NOTAL)
1. REF A REQUESTED ASSISTANCE IN OBTAINING STATUS OF PAYMENT ON INVOICES 10046 AND 10047 DTD 13 JUN 86 FOR THE TOTAL AMOUNT OF $5288.15. CONTRACT N00189-86M-A537 APPLIES. NO RECORD OF PAYMENT FOUND AT FAADCLANT.
2. REQUEST ADVISE STATUS AND ACTION TAKEN TO EXPEDITE PAYMENT.

0021 EST

MGMCOMP MGM

5241 (R 7-82)

TO REPLY BY MAILGRAM MESSAGE, SEE REVERSE SIDE FOR WESTERN UNION'S TOLL - FREE PHONE NUMBERS

9-11-86 ⑤

1986 SEP 10 PM 2:57

- mailed fuel doct.
- no pay day
Probably 12-2-86

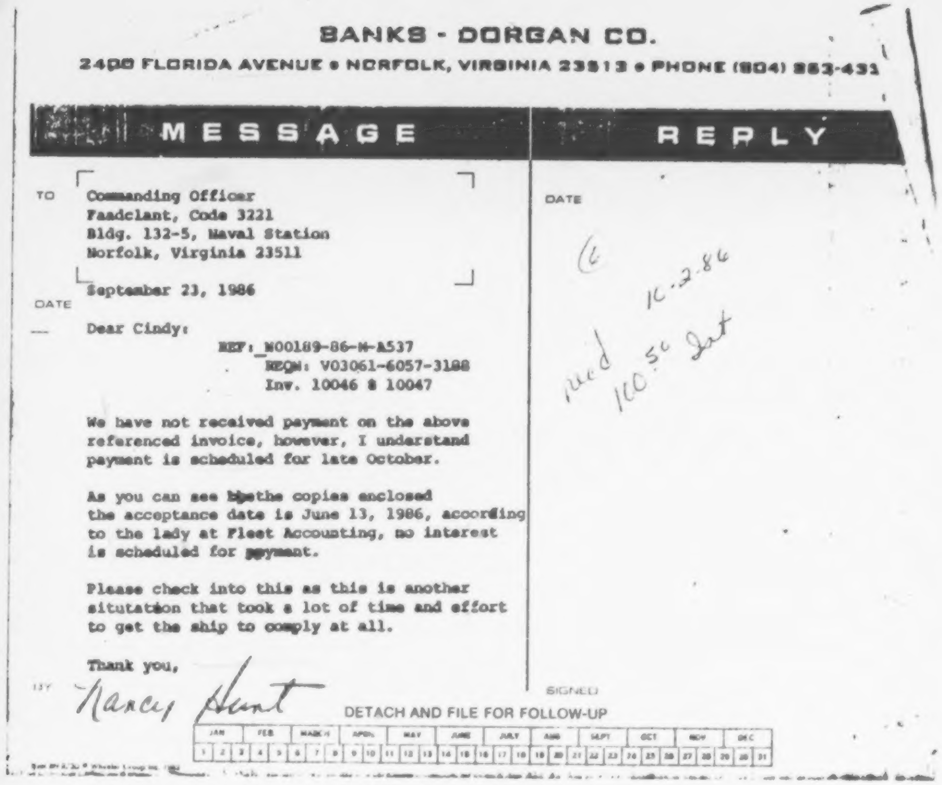
```
◆
IPM38UV
1-009621A253 09/10/86
ICS IPMRYND RNO
ZCZC 04191 RENO NV 09-10 1116A PDT RYNC
ICS IPM38UV
BT

1-006521C253 09/10/86
ICS DODCRSB ABN
 03150 DOD CRC ALBANY GA 101807Z SEP 86/253
FMS
BANKS DORGAN CO. DLR
2400 FLORIDA AVE
NORFOLK VA

1 P RULYS605120 2531720 NA-CNRF
P R 101720Z SEP 86
FM USS IOWA
TO RUCBSAA/COMNAVSURFLANT NORFOLK VA
INFO RULYMPA/COMCRUDESGRU EIGHT
RUCOSAA/FAADCLANT NORFOLK VA
RUCLRFA/BANKS DORGAN CO
     2400 FLORIDA AVE
     NORFOLK VA 23513
ACCT NA-CNRF
UNCLAS //N07200//
SUBJ: UNPAID INVOICES FM BANKS DORGAN CO
A. COMNAVSURFLANT NORFOLK VA 082327Z SEP 86
1. IRT REF A. INVOICES 10046 AND 10047 AND CONTRACT N00189-56M-A537
FOR A TOTAL AMOUNT OF 5,288.15 CERTIFIED AND MAILED 10 SEP 86 TO
PROCESS PAYMENT.

1312 EST

NNNN
1325 EST
◆
IPM38UV
```



BANKS - DORGAN CO.
2400 FLORIDA AVENUE • NORFOLK, VIRGINIA 23513 • PHONE (804) 853-431

MESSAGE

TO
Commanding Officer
Faadclant, Code 3221
Bldg. 132-5, Naval Station
Norfolk, Virginia 23511

DATE September 23, 1986

Dear Cindy:

REF: N00189-86-M-A537
REQN: V03061-6057-3188
Inv. 10046 & 10047

We have not received payment on the above referenced invoice, however, I understand payment is scheduled for late October.

As you can see bythe copies enclosed the acceptance date is June 13, 1986, according to the lady at Fleet Accounting, no interest is scheduled for payment.

Please check into this as this is another situtation that took a lot of time and effort to get the ship to comply at all.

Thank you,

BY Nancy Hunt

REPLY

DATE

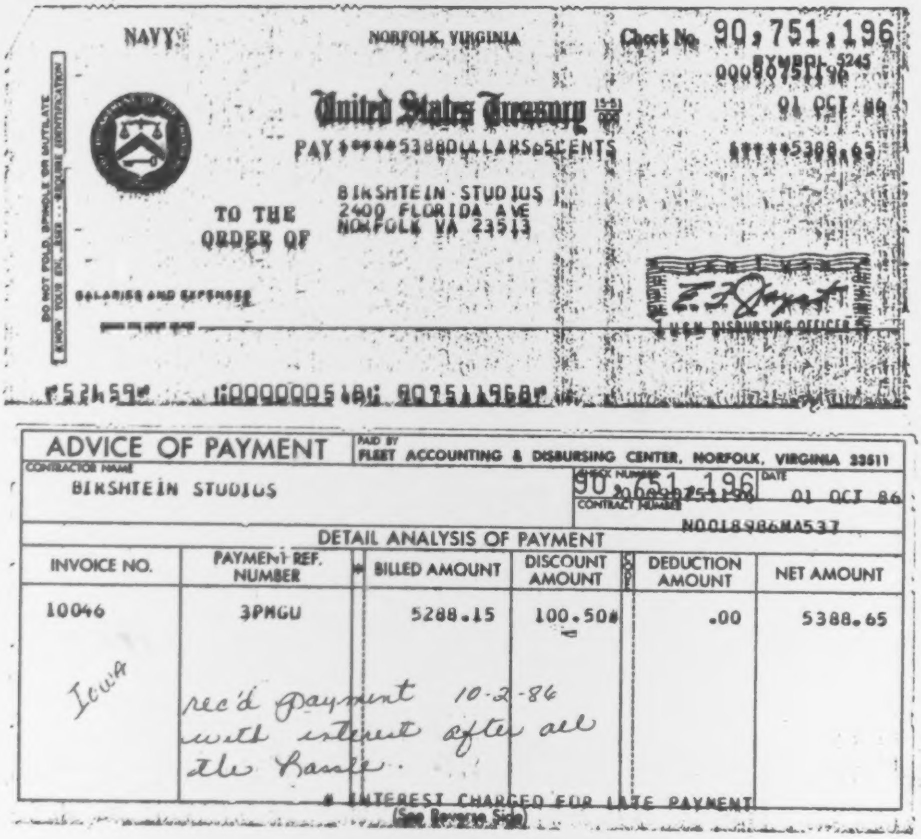
6

rec'd 10-2-86
100.50 Int

SIGNED

DETACH AND FILE FOR FOLLOW-UP

JAN FEB MARCH APRIL MAY JUNE JULY AUG SEPT OCT NOV DEC
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31



NAVY NORFOLK, VIRGINIA Check No. 90,751,196

SYMBOL 5245
00090751196

United States Treasury 15-51/000

01 OCT 86

PAY ****5388DOLLARS65CENTS $****5388.65

DO NOT FOLD, STAPLE OR MUTILATE
KNOW YOUR EN... REQUIRE IDENTIFICATION

TO THE ORDER OF
BIKSHTEIN STUDIOS
2400 FLORIDA AVE
NORFOLK VA 23513

SALARIES AND EXPENSES

U.S.N. DISBURSING OFFICER

52459 000000518 907511968

ADVICE OF PAYMENT

PAID BY FLEET ACCOUNTING & DISBURSING CENTER, NORFOLK, VIRGINIA 23511

CONTRACTOR NAME: BIKSHTEIN STUDIOS

CHECK NUMBER: 90,751,196

DATE: 01 OCT 86

CONTRACT NUMBER: N0018986MA537

DETAIL ANALYSIS OF PAYMENT

INVOICE NO.	PAYMENT REF. NUMBER	*	BILLED AMOUNT	DISCOUNT AMOUNT	CODE	DEDUCTION AMOUNT	NET AMOUNT
10046	3PMGU		5288.15	100.50*		.00	5388.65
Iowa	rec'd payment 10-2-86 with interest after all the hassle.						

* INTEREST CHARGED FOR LATE PAYMENT
(See Reverse Side)

Note: Voucher does NOT show Interest percentage
or # of days

5

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BANKS-DORGAN COMPANY

T/A Birshtein Studios

2400 FLORIDA AVENUE
NORFOLK, VIRGINIA 23513

AREA CODE 804 · PHONE 853-4333

INVOICE

№ 10178

10178

PO: [illegible]-86-[illegible]-A905
REQN: V03368-6052-2675

SOLD TO
Supply Officer
USS Nimitz (CVN-68)
FPO New York 09542-2820

SHIP TO
SERVICE FOR:
USS Nimitz (CVN-68)
FPO New York 09542-2820
(NORFOLK, VA.)

DATE OF INV	PURCHASE ORDER NO	CUSTOMER	C.O.D.	CHARGE	ORDERED BY	SHIPPED VIA
[illegible]	[illegible]	USS Nimitz (CVN-68)		XXX		OUR TRUCK/INSTALLATION

QUANTITY	UNIT	ITEM	DESCRIPTION	UNIT PRICE	AMOUNT
1	JB	Manufacture & install a four part stage consisting of three each stepped segments and one rectangular platform. Risers to be carpeted w/100% wool carpet - color: Admiralty Blue		1,995.00	1,995.00
1	[illegible]	Weld [illegible] to the deck or bulkheads		[illegible].00	[illegible].00
1	[illegible]	Construct & install a three pc. news-casting desk.		1,475.00	1,475.00
[illegible]	[illegible]	[illegible]		[illegible]	[illegible]

SUBTOTAL		
SALES TAX		
DELIVERY CHARGE		
TOTAL		[illegible]

RECEIVED, INSPECTED & ACCEPTED BY (SIGNATURE)

DATE [illegible]

NAME & RATING (PRINT) [illegible]

SELLER MAY AT HIS DISCRETION, CHARGE THE MAXIMUM LEGAL INTEREST RATE ALLOWED ON INVOICES PAST DUE 30 DAYS OR LONGER.

BUYER FURTHER AGREES THAT IF THIS MATTER MUST BE FORWARDED TO AN ATTORNEY FOR COLLECTION, SAID BUYER SHALL BE RESPONSIBLE FOR ALL COSTS OF COLLECTION, INCLUDING A REASONABLE ATTORNEY'S FEE.

TERMS NET E.O.M. Net 30 Days

EXAMINE THESE GOODS BEFORE CUTTING. NO CLAIMS ALLOWED AFTER MERCHANDISE HAS BEEN CUT.

[illegible] COMPANY
2400 FLORIDA AVENUE   AREA CODE 804 [illegible]
NORFOLK, VIRGINIA 235[illegible]
Quality & Service since [illegible]
[illegible]

[illegible]

10 22 86 called Fleet Acct No record

10/23/86 Lacy will type Contract so we can get paid -

(7 [illegible] out

(2 September 17, 1986

Supply Officer
USS Nimitz CVN-68
FPO New York, N.Y. 09542-2820

REF: PO#N00189-86-M-A905
REQN#V03368-6052-2675
INV.#10178, 7-30-86, $3,660.00

A call to Fleet Accounting and Disbursing reveals no evidence of the above referenced invoice(s) being submitted for payment.

Please take the time to certify and submit the paperwork necessary for Fleet Accounting. As you can see the sign off and acceptance date is Aug. 14, 1986. We would appreciate certification as of this date so that we may receive our payment in a timely manner. Certification at the current date will result in a 30-45 day delay in payment.

Your cooperation in this matter is greatly required and appreciated.

Yours truly,

Nancy S. Hunt

Encl:
cc: Commanding Officer
Comsurlant/Comsublant/Comnavairlant

(1 4 10 86 called Fleet Acct no record
(3 11 7 86 called Fleet Acct no record

(4 11 7 86 second request to ship
(8 11 5 86 SK2 Durecker picked up contract
(10 11 18 86 Called Fleet Acct no record
(11 11 18 86 called SK2 Durecker - says he mailed them to Fleet Acct
(12 11-25-86 called Fleet Acct - no record
(13 12 3 86 called Fleet Acct no record
(13 12 3 86 called ship Durecker not there left message.

(15 12-9 86 called Fleet Acct - no record
(16 12 9 86 called SK2 Durecker gave to Commanding [illegible]
(17 12 9 86 commander [illegible] called back [illegible] today and [illegible] called to Fleet Acct. requested I call Fleet Acct 12 11 86 and if answer not there I'm to call him back

Department of the Navy
USS NIMITZ (CVN 68)
FPO New York 09542-2820

1616
Ser 07/ 4100
28 OCT 1986

Banks-Dorgan Co.
2400 Florida Avenue
Norfolk, VA 23513

Dear Ms. Hunt:

In response to your two letters dated September 17, 1986 (second request 10-7-86) the following information is provided:

a. Invoice no. 10174 dated 7/30/86 for requisitions V03368-6093-B392 and B397 was forwarded to FAADCLANT 29 SEP 86 under certified mail number P145 742 420.

b. Invoice no. 10178 dated 7/30/86 for requisition V03368-6052-2675 has not been processed for payment since no hard copy contract is yet available. Communication with your company and with NSC Norfolk indicates the contract has not yet been typed. However, liaison with NSC Norfolk indicates the contract will be available Wednesday 29 OCT at which time the invoice will be processed for payment.

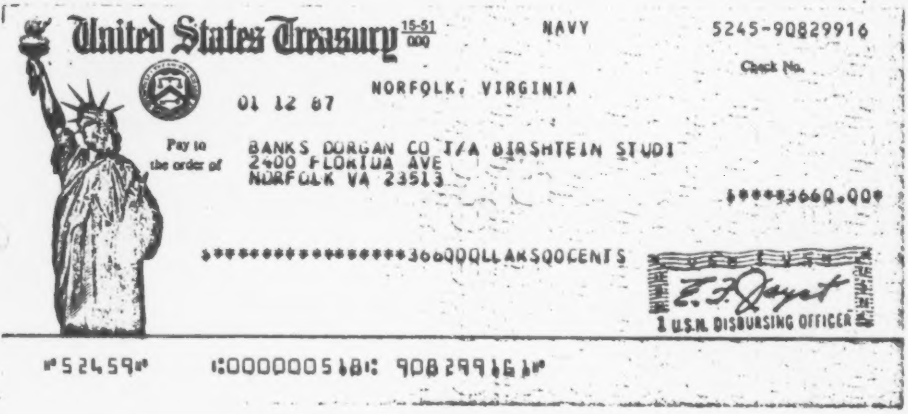
I hope this information answers your questions. If you need any further assistance please feel free to call me (444-7309).

Sincerely,

F.X. Poole
F. X. POOLE
Commander, Supply Corps, U.S. Navy
Supply Officer
By direction of the
Commanding Officer

Copy to:
NSC Norfolk, Pierside Procurement

3/12/87
INTEREST ReFused so FAR.
Ro



United States Treasury 15-51/000 NAVY 5245-90829916

Check No.

NORFOLK, VIRGINIA

01 12 87

Pay to the order of

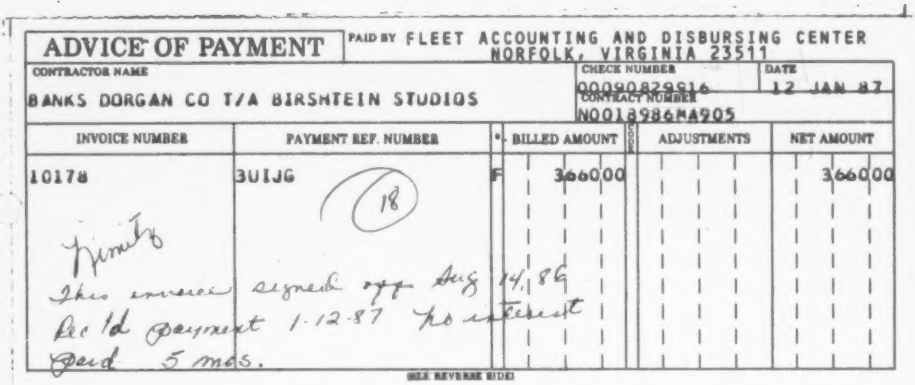
BANKS DORGAN CO T/A BIRSHTEIN STUDI
2400 FLORIDA AVE
NORFOLK VA 23513

$****3660.00*

$*****************3660DOLLARS00CENTS

E. F. Jayat
U.S.N. DISBURSING OFFICER

⑈52459⑈ ⑆000000518⑆ 90829916⑈



ADVICE OF PAYMENT PAID BY FLEET ACCOUNTING AND DISBURSING CENTER
NORFOLK, VIRGINIA 23511

CONTRACTOR NAME BANKS DORGAN CO T/A BIRSHTEIN STUDIOS	CHECK NUMBER 00090829916	DATE 12 JAN 87
	CONTRACT NUMBER N0018986MA905	

INVOICE NUMBER	PAYMENT REF. NUMBER	*	BILLED AMOUNT	CODE	ADJUSTMENTS	NET AMOUNT
10178	3UIJG ⑱	F	3660 00			3660 00

This invoice signed off Aug 14, 86
Rec'd payment 1-12-87 No interest
Paid 5 mos.

(SEE REVERSE SIDE)

6

Quality & Service since 1907

BANKS-DORGAN COMPANY

T/A Birshtein Studios

2400 FLORIDA AVENUE
NORFOLK, VIRGINIA 23513

INVOICE

No. 10351

[illegible]
10351

AREA CODE 804 · PHONE 853-4333

[illegible]

SOLD TO [illegible]
[illegible]
[illegible]
Norfolk, VA

SHIP TO [illegible]
[illegible]
[illegible]
[illegible]

DATE OF INVOICE	PURCHASE ORDER NO.	CUSTOMER	C.O.D.	CHARGE	ORDERED BY	SHIPPED VIA
[illegible]	[illegible]	[illegible]		[illegible]	[illegible]	[illegible]

QUANTITY	UNIT	ITEM	DESCRIPTION	UNIT PRICE	AMOUNT
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]		[illegible]	[illegible]	[illegible]	[illegible]
[illegible]		[illegible]	[illegible]	[illegible]	[illegible]

SUBTOTAL		
SALES TAX		
DELIVERY CHARGE		
TOTAL		[illegible]

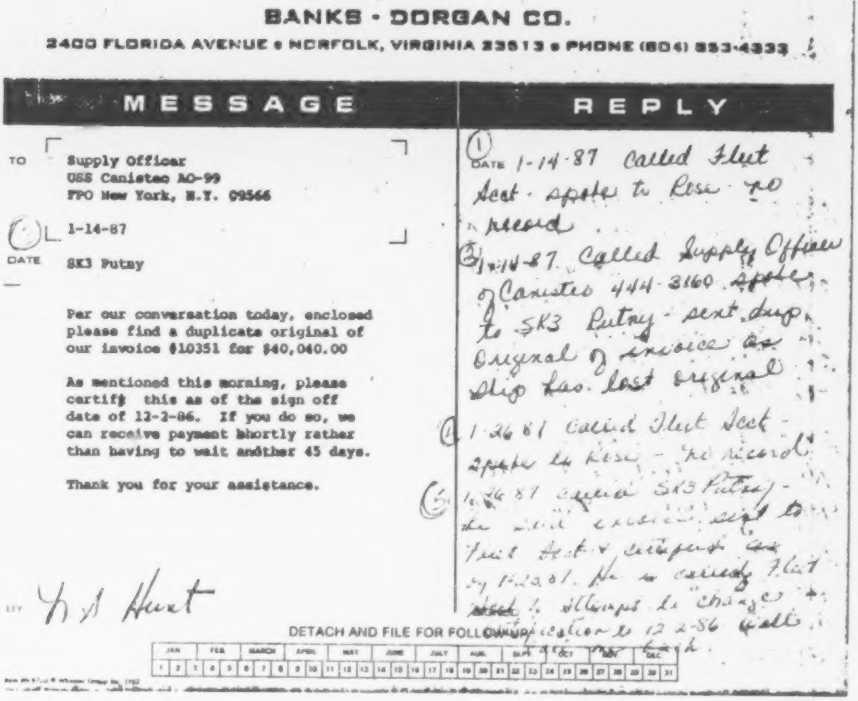
[illegible] [illegible] [illegible]
RECEIVED, INSPECTED & ACCEPTED BY (SIGNATURE) — DATE — NAME & RATING (PRINT)

SELLER MAY AT HIS DISCRETION CHARGE THE MAXIMUM LEGAL INTEREST RATE ALLOWED ON INVOICES PAST DUE 30 DAYS OR LONGER.

BUYER FURTHER AGREES THAT IF THIS MATTER MUST BE FORWARDED TO AN ATTORNEY FOR COLLECTION, SAID BUYER SHALL BE RESPONSIBLE FOR ALL COSTS OF COLLECTION, INCLUDING A REASONABLE ATTORNEY'S FEE.

TERMS: NET E.O.M.

[illegible] NO CLAIMS ALLOWED AFTER MERCHANDISE HAS BEEN CUT



BANKS - DORGAN CO.

2400 FLORIDA AVENUE • NORFOLK, VIRGINIA 23513 • PHONE (804) 853-4333

MESSAGE

TO
Supply Officer
USS Canisteo AO-99
FPO New York, N.Y. 09566

1-14-87
DATE

SK3 Putny

Per our conversation today, enclosed please find a duplicate original of our invoice #10351 for $40,040.00

As mentioned this morning, please certify this as of the sign off date of 12-2-86. If you do so, we can receive payment shortly rather than having to wait another 45 days.

Thank you for your assistance.

BY N A Hunt

REPLY

① DATE 1-14-87 Called Fleet Acct. spoke to Rose - no record.

② 1-14-87. Called Supply Officer of Canisteo 444-3160 spoke to SK3 Putney - sent dup. Original of invoice as Ship has lost original

④ 1-26-87 Called Fleet Acct - spoke to Rose - "no record"

⑤ 1-26-87 called SK3 Putney - he [illegible] invoice sent to Fleet Acct. & certified as of 1-23-87. He is calling Fleet Acct. to attempt to change certification to 12-2-86 & will [illegible] back.

DETACH AND FILE FOR FOLLOWUP

JAN FEB MARCH APRIL MAY JUNE JULY AUG SEPT OCT NOV DEC

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31

⑥ 1-26-87 SK2 Paley called back doesn't know when the certified invoices (12-2-86 or 1-23-87)

⑦ 1-28-87 Called Fleet Sect still no record

⑧ 2-2-87 Called Fleet Sect spoke to Jackie - no record.

⑨ 2-4-87 called Fleet Sect - no record - Called SK1 Cardonez @ Comnavsurflant

⑩ 2-9-87 called Fleet Sect. No record. Spoke to Jackie.

⑪ 2-9-87 Called SK1 Cardonez He will look in to matter, mailing copies to him today → #12 telegram

⑬ 2-24-87 Called Fleet Sect. per Fleet Sect returned to activity 2-11-87. No reply since

Western Union Mailgram

WESTERN UNION C.R.C.
MCLB DRAWER 38
ALBANY GA 31704 14AM

(12)

Cindy Lawrence
444-3838

[illegible]
444 3[illegible] *
3838

4-000084A045 02/14/87 ICS DODCRSA ABN NKFA
01480 DOD CRC ALBANY GA 140509Z FEB 87/045

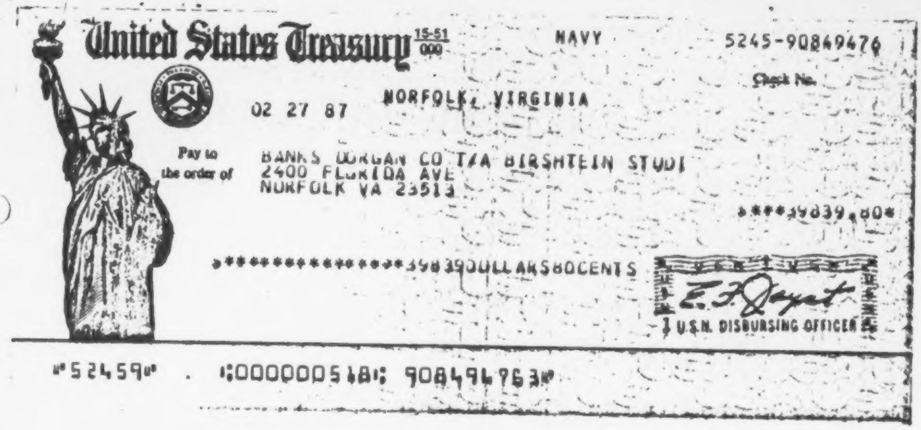
BANKS DORGAN CO
2400 FLORIDA AVE
NORFOLK VA 23513

1 R RUCOSGG0052 0442208 NA-CNRF
R 132014Z FEB 87 ZYB
FM FAADCLANT NORFOLK VA
TO RULYRTT/USS CANISTEO
INFO RUCBSAA/COMNAVSURFLANT NORFOLK VA
RUCLRFA/BANKS DORGAN COMPANY
     2400 FLORIDA AVENUE
     NORFOLK VA 23513
ACCT NA-CNRF
UNCLAS //N07200//
SUBJ: COPY OF BANKS-DORGAN COMPANY INV 10351, DTD 30 SEP 86 FOR 40,040.00
A. REQN V04849-6119-2979 UNDER CONTRACT N00189-86-C-0448
B. NAVSUP 485, PAR 4336
1. SUBJ INV, BILLING UNDER REF A, HAS BEEN RECEIVED THIS CENTER, WITHOUT SIGNED INSPECTION REPORT REQUIRED BY REF B.
2. REQ CONFIRMATION BY RTN MSG AS TO RECEIPT AND ACCEPTANCE MAT/SERVICES.
3. PMT INV PENDING. DO NOT RESUBMIT.

00:09 EST

MGMCOMP (14 2-26-87 rec'd call from [illegible] Colone[illegible] stated
Fleet Acct had rec'd telegram from Can~~[illegible]~~isteo
stating 12-3-86 as sign off

5241 (R 7/82)



United States Treasury $\frac{15\text{-}51}{000}$ NAVY 5245-90849476

Check No.

02 27 87 NORFOLK, VIRGINIA

Pay to the order of
BANKS DORGAN CO T/A BIRSHTEIN STUDI
2400 FLORIDA AVE
NORFOLK VA 23513

****39839.80*

*****************39839DOLLARS80CENTS

E. F. Jayat
U.S.N. DISBURSING OFFICER

⑈52459⑈ . ⑆000000518⑆ 908494763⑈

ADVICE OF PAYMENT

PAID BY FLEET ACCOUNTING AND DISBURSING CENTER
NORFOLK, VIRGINIA 23511

CONTRACTOR NAME BANKS DORGAN CO T/A BIRSHTEIN STUDIOS	CHECK NUMBER 00090849476	DATE 27 FEB 87
	CONTRACT NUMBER N0018986C0448	

INVOICE NUMBER	PAYMENT REF. NUMBER	*	BILLED AMOUNT	CODE	ADJUSTMENTS	NET AMOUNT
10551	3VXIV	F	40040 00		200 20-	39839 80

(15)

This invoice is from 12·2·86
Terms are 1/2 pct twenty days
Paid 2·27·87 still took discount + did not pay interest

(SEE REVERSE SIDE)

STATEMENT OF
JOHN C. RENNIE
ON BEHALF OF
NATIONAL SMALL BUSINESS UNITED
BEFORE THE
SENATE GOVERNMENTAL AFFAIRS COMMITTEE
HOLDING HEARINGS ON
S. 328, PROMPT PAYMENT ACT AMENDMENTS OF 1987
MARCH 19, 1987

Mr. Chairman and Members of the Committee:

My name is John C. Rennie and I am the President/CEO of Pacer Systems, Inc. located in Billerica, Massachusetts. Pacer Systems is a small aerospace company which delivers both professional services and hardware to the government. I am appearing today on behalf of National Small Business United (NSBU). I serve on NSBU's Board and am also Chairman of its legislative Subcommittee on Government Procurement. NSBU is a new, national trade association formed from the recent merger of the National Small Business Association, a multi-industry trade association founded in 1937, with Small Business United, a coalition of regional, state and metropolitan small business associations organized in 1981. NSBU represents 50,000 small businesses nationwide. Both SBU and NSBA were active supporters of efforts to improve the Prompt Payment Act of 1982.

Mr. Chairman, we applaud the fact that you and every member of your Committee has joined in co-sponsoring Senator Sasser's Prompt Payment Act Amendments of 1987, S. 328.

Small businesses do not have the resources to go through the bureaucratic maze in order to collect funds which are rightfully theirs. We thought their problems were solved when the Prompt Payment Act of 1982 (PL 97-177) was enacted into law (or at least we felt it was a major step forward, which it was). To some extent, the problems were alleviated; but many small businesses are still experiencing difficulty in receiving prompt payment -- a situation which can result in ruin for the smaller firm if substantial amounts owed by a federal agency or prime contractor are not paid in a timely fashion. Many of those smaller companies have had to borrow capital in order to survive while awaiting payment from the federal government or prime contractor.

During a four-month test period, conducted in 1985 (three years after enactment), the General Accounting Office (GAO) found that an estimated 24% of federal payments, or roughly $7.7 billion, were made after the due date; and the required interest penalties were seldom paid. GAO estimated that agencies should have been subjected to 278,000 late payment penalties amounting to approximately $15 million in interest on late payments during this test period. In addition, GAO estimates that during this period about 146,000 early payment discounts, totaling approximately $2 million, were taken after the discount period had expired.

The Prompt Payment Act of 1982 requires federal agencies to automatically pay an interest penalty on all accounts still due after 30 days. However, agencies are allowed a 15-day grace period in which to make payments before interest would be charged. If agencies fail to make those payments, interest would accrue from the 31st day. It would appear that the 15-day grace period is being abused. According to the GAO, 63% of the late payments reviewed were paid during the grace period and thereby incurred no penalties. NSBU supports Section 4 of S. 328 which would remedy this situation by reducing the current 15-day grace period to seven days, and eliminating the grace period effective October 1, 1989.

Based on fiscal 1983 performance, the Office of Management and Budget (OMB) determined that 99% of the government's bills were paid on time -- a figure they are still using. At a June 1986 hearing before the Senate Small Business Committee, the OMB Deputy Associate Director for Financial Management admitted that the 1% of late payments represented almost 300,000 transactions.

When the original legislation was reported, the House Government Affairs Subcommittee on Legislation and National Security stated "The intent of the Committee that agencies pay their bills by the required payment date is in no way diminished by the inclusion of provisions of authorizing grace periods."

It is commendable that Section 4 of S. 328 reduces, and eventually eliminates, the grace period as the Senate version of the original Act contained no extra 15-day grace period -- a section that was added by the House as the Executive Branch was convinced the grace period was essential to avoid imposing substantial costs to the government. In essence, what the 15-day grace period does is to have small businesses subsidize the government by lending them interest-free money for those extra days.

The Coalition for State Prompt Pay has shown that reports by the Office of Management and Budget in 1984 and 1985 indicated that the Defense Department was the most likely to pay its bills late, with the Navy accounting for most of the late payments. In testimony before the Senate Appropriations Committee in August 1986, the Deputy Secretary of Defense testified that DoD was "reviewing the flexibilities available to us under the Prompt Payment Act" as a means of cutting costs and proposed that DoD pay its bills 10 days into the grace period to reduce outlays. This type of thinking flies directly in the face of the spirit and intent of the Prompt Payment Act. Small business, in fact any size business, which delivers required goods or services to the government deserves to be paid promptly... period. Playing cash flow games, thereby increasing contractors' costs and risks is unconscionable and will cause many companies to cease to do business with the government.

The GAO report, published in August of 1986, noted that many of the payment problems could be traced back to the fact that regulations implementing the Prompt Payment Act have never been included in the Federal Acquisition Regulation.

Other problems reported to NSBU by contractors have involved failure by agencies to commence payment procedures on invoices until the expiration of thirty days; rejecting invoices as not being proper after the 15-day grace period has elapsed, and, thereby, beginning the countdown all over again when the invoice is resubmitted -- or, all too often, "losing" invoices. Payment of interest penalties should be automatic -- many small businesses are afraid to take on the federal government and should not have to beg the government for what is due under the law. Agencies have also excluded progress payments from the provisions of the Act and have not applied prompt payment requirements to construction contract payments. To add insult to injury, some federal agencies take early payment discounts even though payment is made long after the discount deadline has been passed.

It has been slightly over four years since the original Act became law. This would seem ample time for the agencies to get their act together and fully implement internal procedures for seeing to it that they pay their bills on time. Granted, there has been significant improvement, but some agencies have utilized that time to exploit the ambiguities and loopholes in the law as evidenced by the hearings held last year by Senator Trible.

Now I would like to turn to Section 7 of the proposed legislation regarding prompt payment by prime contractors to their subcontractors. NSBU strongly supports Section 7 as it extends the Act's coverage to subcontractors doing work for federal prime construction contractors. We firmly believe prime contractors should be required to pay subcontractors promptly as well. Several states already have prompt pay laws for subcontractors. Prompt payment is needed by those small subcontractors in order for them to remain competitive and stay in business. We understand the difficulties the primes may have when they receive late payment from the government -- their cash flow is interrupted and they must meet payrolls and pay their suppliers. However, most primes come under the category of "big" business and subcontract out a great deal of the specialty work. The small subcontractor has the same problems with cash flow, meeting payroll, adhering to the costly Davis-Bacon wage provisions, paying suppliers etc. However, because they are small, have higher costs of capital and often operate on a narrower profit margin, they cannot absorb the extra hardship as easily as the primes can. If, as we anticipate, S. 328 resolves the prompt payment problems and the primes are paid on time, we see no reason why the primes should not be expected to pay their small subcontractors on an equally timely basis.

Some states have amended their prompt pay laws to require prime contractors to pay their subcontractors promptly on public projects or be forced to pay interest penalties. Interest penalties are all well and good as late payment is acknowledged. However, during the delay in payment, it will be little consolation to the small business struggling with a cash flow problem. Prompt payment to subcontractors will ensure a better working relationship. When the government pays the prime on a timely basis, not all of the money belongs to the prime -- only that portion which the prime rightfully earned, the rest belongs to the subcontractors. A seven-day turnaround should not be too much of a hardship on the prime -- he has already certified the work of the subcontractor and has been paid for it; and all paperwork should be in readiness for the issuance of a check.

We would be at a loss to understand why any prime contractor could raise reasonable objections to the proposal contained in Section 7. Not only does it conform to the joint policy statement issued by the Associated General Contractors, the American Subcontractors Association, and the Associated Specialty Contractors, but it would seem to us to be a sound business practice especially as subcontractors perform a major portion of the project.

The subcontractor would not be entitled to payment or interest penalties for late payment if a dispute existed as to performance. We agree that any problem between the prime and the subcontractor should be resolved by those parties without government interference, as long as the prime has identified the problem to the federal agency and does not receive any payment for amounts in dispute with the subcontractor until after the dispute has been resolved. We do not see how this could be considered as government intervention in the contract between the prime and the subcontractor.

It is unfortunate we should still be struggling with this problem as the Small Business and Federal Procurement Competition Enhancement Act (PL 98-577) states:

> ".....the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontract with small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals."

Since passage of this Act, we are not aware of any steps that have been taken to implement this policy.

We trust there will be swift action by the Governmental Affairs Committee and the full Senate on this legislation as it is responsive to Recommendation 32 of the 1986 White House Conference on Small Business:

> "Prompt pay legislation should be extended to cover the Postal Service and federally assisted procurement; be strengthened through an amendment to the 1982 Prompt Payment Act to eliminate the 15-day grace period; require automatic payment of interest penalties; more clearly define that the entire payment process, including acceptance, must occur within 30 days; include progress payments and retainage; and require prime contractors to pay their subcontractors within seven days after receiving payment from the government or incur interest payment penalties. In addition, when the government pays the prime contractors late, interest payments shall flow through from prime contractors to subcontractors on a pro-rata basis. The Prompt Payment Act shall be vigorously enforced by all branches of government."

Mr. Chairman, we wish to extend our thanks to you for expediting the scheduling of hearings on this most important issue. Our thanks to Senator Sasser for reintroducing Senator Trible's proposal, and to the members of the Committee and other Members of the Senate who have co-sponsored this legislation -- the number of co-sponsors, we understand, has now reached 78. We would be remiss if we did not publicly acknowledge the efforts of the Senate Small Business Committee members and staff who have resolutely investigated the inherent problems. We stand ready to assist both Committees in having S. 328 passed in an expeditious manner.

Statement of

The Associated General Contractors of America

Presented to the

Committee on Governmental Affairs

United States Senate

on the Subject of

Prompt Payment Act Amendments of 1987

March 19, 1987

AGC is:

- More than 32,500 firms including 8,400 of America's leading general contracting firms responsible for the employment of 4,000,000-plus employees;
- 106 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municpal-utilities facilities

The Associated General Contractors of America represents more than 32,500 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 4,000,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities.

At the outset AGC makes three key points with regard to the vital protections already provided to contruction subcontractors as follows:

- Subcontract provisions contained in the industry's model subcontract forms provide subcontractors with great protections. These include: the right to stop the work, the right to terminate the subcontract, the right to arbitration, and a recourse to the courts.
- Prime contractors provide the owner with a payment and performance bond to guarantee payment of subcontractors and suppliers.
- Prime contractors are required by a federal law, the Miller Act, to provide a payment and performance bond to protect subcontractors and suppliers.

AGC strongly supports amendments to the Prompt Payment Act of 1982, which will ensure that construction progress payments are specifically covered by the law, and that the Government must pay interest to its construction contractors. However, AGC has strong objections to Section 7 of S.328, which would allow the Federal Government, for the first time, to intrude into the business terms of the private subcontract relationship between a general construction contractor and its subcontractors by dictating the payment terms of the private subcontract relationship. This mandatory flow-down would override the business judgment of the general contractor that must be exercised on each subcontract. AGC urges the Senate to drop Section 7 of S.328, while at the same time making the necessary amendments to the Prompt Payment Act to cover prime construction contract progress payments.

Proper Extension of the Act to Prime Construction Contract Progress Payments

In 1982, Congress passed the Prompt Payment Act to ensure that the Government would make timely payments to its contractors. The Act imposed time limits for the making of payments, and imposed late payment interest penalties on the Government. Since then, narrow administrative interpretation of the statute against the intention of the drafters has denied proper application of the statute to prime construction contract progress payments.

In the last Congress, AGC strongly supported amendments to the Prompt Payment Act of 1982 to clarify that progress payments on federal prime construction contracts are specifically covered by the law. AGC considers these amendments equitable and overdue. The proper application of the statute to the prime contract will be of direct benefit to subcontractors as well. If the Government pays general contractors promptly, subcontractors who are performing properly will be paid promptly by the general contractor according to the terms of their private agreement.

Exploitation of Amendments to Serve Narrow Interests of Subcontractors

In the 100th Congress, AGC is once again supporting needed amendments to the Prompt Payment Act contained in the Prompt Payment Act Amendments of 1987, S.328. However, AGC strongly opposes the attempt by subcontractors to unnecessarily mandate the intrusion of the Federal Government into the business terms of the private subcontract relationship between the general contractor and its subcontractors. Section 7 would require general contractors performing Federal construction work to include "prompt payment" clauses in their subcontracts, through Section 7 of the Prompt Payment Act Amendments of 1987, "Payment Clause for Subcontracts Under Construction Contracts."

There is no objective evidence in the record that subcontract payments are in fact a problem on Federal projects. Furthermore, there is no rationale offered for extending the Act beyond the prime contract. Proponents have not explained why the remedial provisions of the Miller Act and the remedial provisions in the private subcontracts should be displaced. These remedial provisions include: stopping the work, termination of the subcontract, arbitration, and, if necessary, recourse to the courts.

AGC emphasizes that prompt payment to subcontractors is not at issue. AGC's standard form subcontract as well as other industry model subcontracts already provide for prompt payment as well as for remedies in the event payment is in dispute.

Proponents of Section 7 also have failed to demonstrate the effect of the proposal on the real party in interest - the Government owner. The record is devoid of evidence from Government construction contracting officials that subcontract payment regulation by the Government would improve the delivery of the construction product to the Government.

If subcontract payment is a problem, what is its magnitude, cause, and effect on the delivery of the construction product? Proponents of Section 7, quite simply, have not produced any objective evidence or considered analysis worthy of moving Congressional action.

Subcontract Payment is the Heart of Private Business Judgment

The payment term is the heart of the private subcontract relationship. Section 7 of S.328 is indeed precedent setting, in that the Federal Government has never before injected itself directly into the business terms of subcontract agreements.

Contrary to the arguments of proponents of Section 7, the existing subcontract flow-down clauses required by the Federal Acquisition Regulation do not legitimate a payment intrusion. Each of the current 28 flow-down clauses pursues one or another of broad national social, economic or environmental policies through procurement policy - not the narrow interest of any one industry group - such as subcontractors. (Attached is an analysis of the 28 flow-down clauses.)

AGC must point out that the Federal Government heretofore has been unwilling to take on the increased responsibility and liability which would result from intruding into private subcontractual relationships between subcontractors and the general contractor.

Some of these areas of increased responsibility and liability include the following:

- To enforce Section 7, Government contracting officers will be required to not only enforce its payment provisions, but also its retention provisions. The Government will necessarily become embroiled in payment disputes and adequacy of performance disputes between general contractors and subcontractors.
- The general contractor provides the Government agency with performance and payment bonds. A performance bond assures the Government that the general contractor will complete its work. A payment bond assures the Government that the general contractor pays its subcontractors and material suppliers. With these bonding assurances, backed by reputable surety firms, the Government agency can safely make rapid payment to the general contractor. Most subcontractors do not provide these same bonding protections to the general contractor. Consequently the general contractor must use one of the few tools available to it to assure adequate and on-time performance by a subcontractor, and to assure that subcontractors pay their sub-subcontractors and suppliers. That tool is payment to the subcontractor. If the Government, through implementation of Section 7, eliminates that "tool," is the Government ready to accept the responsibility and liability of lack of performance on the part of the subcontractor or lack of payment by the subcontractor to its sub-subcontractors?
- Under Section 7 a general contractor, under a two-year

construction contract with the Government, would be required to pay its subcontractor in full upon completion of the subcontractor portion of the work, which may occur six months after the start of the contract. If, however, at the completion of the entire two-year construction project, a defect is found in the work that the subcontractor completed and was fully paid for 18 months before, is the Government ready and willing to assume total liability for the necessary corrections in that work since the Government required the general contractor to pay that subcontractor upon completion of its portion of the work?

The Government under established procurement rules has properly avoided these types of responsibilities and liabilities by contracting with one party through a single contract with the general contractor. Consequently, these responsibilities and liabilities have rested where they properly belong -- with the general contractor in administering its subcontracts. Section 7 would reverse this well-considered judgment and ultimately jeopardize efficient delivery of construction to the Government by significantly impairing the business judgment and project control by the general contractor.

As attachments to this statement, AGC submits further analyses of the impact that Section 7 of S.328 will have on Government construction contracting. The first is a paper prepared by the Washington, D.C. law firm of King & King. The second is a letter addressed to the Honorable Dale Bumpers, Chairman of the Senate Committee on Small Business. In response to AGC's opposition to Section 7 of S.328, a Senate Committee on Small Business Staff Background Paper on Prompt Pay, dated February 3, 1987, has been issued. The Staff Background Paper has also served as the basis, virtually verbatim, for a Question and Answer Paper prepared by a subcontractor organization dated February 16, 1987. These papers attempt to rebut AGC's opposition to payment terms in private subcontracts on Federal construction projects. In the interest of providing Committee members with alternative counsel, AGC submitted to Senator Bumpers the issue-by-issue analysis of the Staff Background Paper.

AGC respectfully submits that a careful consideration of the measure will reveal that the Senate has not been presented with sufficient evidence to warrant Congressional reversal of established procurement policy by enacting Section 7 of S.328.

AGC requests the support of the Senate Committee on Governmental Affairs in striking Section 7 of S.328.

LAW OFFICES
KING & KING
CHARTERED
SUITE 650
2033 M STREET, N. W.
WASHINGTON, D. C. 20036
(202) 296-5195

HAROLD I. ROSEN

GEORGE A. KING (1855-1938)
WILLIAM B. KING (1861-1930)
JOHN W. GASKINS
COUNSEL
TLX: 89 2612
FAX: (202) 775-0839

February 18, 1987

HAND DELIVERED

Mr. John W. Sroka
Executive Director - Occupational Divisions
Associated General Contractors of America
1957 E Street, N.W.
Washington, D.C. 20006

Re: Prompt Payment Act Amendments of 1987

Dear Mr. Sroka:

You have asked me to address the impact that Section 7 of the proposed Prompt Payment Act Amendments of 1987 will have on construction contracting. Section 7 contains the provisions that would require government construction contractors to include prompt payment provisions in their subcontracts and purchase orders calling for payments under subcontracts and purchase orders in accordance with prevailing industry standards and requiring the payment of late payment interest penalties. These provisions will have tremendous impact on the present procedures for payments under subcontracts and purchase orders. Moreover, these changes are totally unnecessary and wholly unwarranted. My detailed comments regarding the proposed subcontract provisions are enclosed.

I hope AGC is successful in having the subcontract payment requirement removed from the proposed Prompt Payment Act Amendments.

Very truly yours,

Harold Rosen
Harold I. Rosen

HIR/jls
Enclosure

KING & KING
CHARTERED

COMMENTS UPON SECTION 7 OF THE PROPOSED PROMPT PAYMENT ACT AMENDMENTS OF 1987

Introduction

The Prompt Payment Act of 1982 was promulgated to ensure that the government would make timely payments to its contractors. The Act imposes time limits for the making of payments and imposes late payment interest penalties on the government for its failure to make timely payments. The Act, however, has some loopholes. The Prompt Payment Act Amendments of 1987 are intended to close those loopholes.

One of those loopholes involves the question of whether construction contracting is covered by the Prompt Payment Act. One of the purposes of the Amendments is to clarify that construction procurement is indeed subject to the terms of the Prompt Payment Act. With regard to construction contracts, the Amendments go considerably beyond that purpose.

Section 7 of the Amendments Goes Entirely Beyond The Intent Of The Prompt Payment Act

Section 7 of the Prompt Payment Act Amendments goes considerably beyond bringing construction contracts under the terms of the Act. The Amendments would also require government construction contractors to include payment provisions in their subcontracts and purchase orders calling for prompt payments under the subcontracts and purchase orders. Furthermore, under the terms of section 7, those payments would have to be made in accordance with prevailing industry standards. Section 7 would go even further and prescribe a penalty or remedy for late payments to subcontractors in the form of late payment interest charges.

The Prompt Payment Act was never intended to address the payment terms between the government's contractors and its subcontractors and suppliers. Therefore, section 7 of the Prompt Payment Act Amendments goes entirely beyond the intent of the Prompt Payment Act and tremendously broadens the scope of the Act. For that reason alone, section 7 has no place in the Prompt Payment Act Amendments of 1987.

Section 7 Violates The Historic Privity Of Contract Relationship Between Contractors And Their Subcontractors

Payment is a material term of any contract or subcontract. For a contract to be valid, it must include the terms of payment. Subcontracts and purchase orders always include payment provisions. The terms of payment are established through negotiation by the contracting parties. It is a matter properly determined by the parties who are in privity of contract with one another.

Privity of contract is a concept that was developed hundreds of years ago by the English common law. Privity is the connection or relationship which exists between two or more contracting parties having a derivative and mutual interest in a contract. Third parties not a party to a contract have no privity of contract. Historically, the rights and obligations of parties in privity are paramount to the rights and obligations of any third party. In fact, in only very limited circumstances can a third party gain any right in a contract between two other parties.

The privity relationship between parties is of the highest priority and should be protected by the law. The rights of those parties to determine and agree upon the terms of their contract should be left to the parties. Interference with that privity relationship, including the rights and obligations arising from the contract, should be restricted. The imposition of payment requirements by the government in subcontracts interferes with that privity of contract principle.

The Federal Government Has Never Before Projected Itself Directly Into The Terms Of Contractor-Subcontractor Agreements

Privity of contract is a paramount principle whose integrity has generally not been interfered with by the federal government. The only areas in which the federal government has injected itself involving subcontractor matters involves socio-economic programs of the federal government. This includes such things as minority business enterprise development and the employment of handicapped and war veterans. These programs address areas of concern to the nation as a whole and are intended to promote equality and equal opportunity. The federal government has never injected itself into business terms of subcontract agreements having no bearing on social or economic goals of the country. Section 7 is the first instance of such an intrusion by the federal government.

While section 7 is the first instance in which the federal government has ever attempted to impose material provisions into subcontract agreements, it has on occasion ventured indirectly into subcontractor matters. In those instances, it was found that the federal government's intrusions created more problems than they solved. For example, a number of years ago, the Bureau of Reclamation of the Department of the Interior and the General Services Administration decided to require prime contractors to list with their bids proposed subcontractors they intended to use on government projects. Such subcontractor listings were intended to reduce bid shopping and bid peddling and coincidentally were strongly supported by subcontractor organizations. However, the subcontractor listing requirements resulted in serious impediments to the procurement system. A multitude of bid protests and lawsuits ensued. It was impossible to effectively administer the subcontractor lising program. As a result, the subcontractor listing requirements were dropped.

The mere listing of subcontractors created overwhelming problems. It would have to be anticipated then that the imposition of payment terms into subcontracts will generate even further administrative burdens than did the subcontractor listing requirements.

Another area in which the federal government has strongly avoided imposing itself involves the area of subcontractor claims. Subcontractor rights and remedies, including claims and claims procedures, are the subject of the terms of each subcontract and the applicable law. Claims are generally governed by the subcontract terms. Those terms are a matter of negotiation and subcontract drafting skills. Claims matters between subcontractor and prime contractor under those terms are best left to the subcontracting parties. The government has recognized this in the past.

The Commission on Government Procurement studied whether to allow subcontractors to have direct access to the administrative boards of contract appeals and to the United States Claims Court to pursue subcontractor claims for which the federal government was responsible. After extensive hearings and investigation, the Commission on Government Procurement, concluded as follows:

> On balance, we have concluded that, although some inequities presently exist with respect to the treatment of subcontractor claims, these inequities are best handled by improved subcontract administration by the prime contractor with appropriate supervision by the Government. The additional problems of contract administration and program management that would arise if subcontractors were given direct access to the Government in disputes and claims outweigh the benefit to be gained. However, Government contracting agencies must remain alert to problems associated with subcontractor claims and assure that those resulting from Government actions are decided fairly.
> [Report of the Commission on Government Procurement, Vol. 4, p. 31 (1972)]

The Commission on Government Procurement therefore decided that the government should not inject itself into subcontractor claim matters. Congress reaffirmed that conclusion with the promulgation of the Contract Disputes Act of 1978 [41 USC §601 et seq]. That act does not permit subcontractors to have direct access to the administrative boards or courts. Again, Congress recognized the importance of the integrity of privity of contract between contractors and their subcontractors.

Coincidentally, subcontractor claims often involve claims for payment. It stands to follow that if the federal government should not be involved in subcontractor claims, it should not be involved in subcontractor payment matters that are often so related to claims.

Section 7 Will Draw The Federal Government Into The Administration Of Subcontract Payment Matters

Section 7 will necessarily require administrative regulation and enforcement. The subcontractor payment provisions can not be self-enforcing. Section 7 will undoubtedly draw the federal government into subcontractor payment matters. There is no valid reason for the federal government to become involved in subcontractor payment administration and enforcement.

In this regard, it should be recognized that the regulation of industry has its points of diminishing returns in which the detriments outweigh the benefits of regulation. Regulation of government contracts is a subject of great concern both to the government and to its contractors. As a result of extensive over-regulation of government contracting, Congress enacted the Office of Federal Procurement Policy Act of 1974 in part to centralize and simplify government procurement regulation. One result of the Act was the promulgation of a government-wide Federal Acquisition Regulation to govern all executive agency federal procurement activities. However, in addition to the Federal Acquisition Regulation, every executive agency has also maintained its own supplement to the Federal Acquisition Regulation so that in effect government procurement activities are now regulated by one overriding set of regulations as well as a multitude of additional individual agency regulations.

Section 7 will only provide an additional area for more regulation and administration by the Executive agencies. At the same time, there is no countervailing benefit to that additional regulation.

Section 7 Will Also Adversely Interfere With Private Contract Rights And Procedures

Payment terms are a material element of any subcontract. Moreover, subcontracts often contain their own provisions for the resolution of disputes and for remedies. Section 7, if adopted, will only serve to erode the rights of the parties in determining the terms of their own agreements. It will negate or otherwise interfere with the private remedies for payment violations which the contractors and their subcontractors are now entitled to determine by their right to contract. Prime contractors and subcontractors must maintain that flexibility in dealing with one another. Each subcontract must be treated separately.

Different contractors prefer to administer their subcontracts in different ways. Different subcontractors have their own ways of administering their business arrangements. Payment terms are one area of those differences. The Federal government should not dictate an end to those differences. Section 7 removes some of that flexibility that the private contracting parties now maintain.

As a related matter, subcontractors often do not furnish payment and performance bonds to their prime contractors. In those cases, payment flexibility is even more critical to prime contractors. Payment procedures and bonding requirements are both essential tools to the prime contractor in managing his subcontractors.

The Government Has The Protection Of The Miller Act To Protect Its Payments -- The Government's Prime Contractors Do Not Have Similar Protection For Their Payments To Subcontractors

With regard to payment bonds, the Miller Act [40 USC §270A] presently requires prime construction contractors to furnish payment and performance bonds to the government. Performance bonds assure the government that the prime contractors will complete their work. Payment bonds assure the government that prime contractors will pay their subcontractors and materialmen. These bonds are furnished by the government's prime contractors. They are not furnished by subcontractors and materialmen.

The Miller Act therefore provides protection to the government for its payments to its prime contractors. Payments can be made promptly by the government to the contractors with the assurance that there is a right of surety indemnification from the payment bond surety in the event it is later concluded that the payments were for some reason improper. The prime contractor does not have that Miller

Act payment bond to fall back on if his payents to subcontractors are later found to have been prematurely or erroneously made. The prime contractor therefore needs added flexibility with regard to subcontractor payments.

The prime contractor's payment bond even provides an adequate and effective remedy for subcontractors and suppliers in the event of nonpayment by prime contractors. In fact, prejudgment and postjudgment interest is also available to subcontractors under the Miller Act.

With the Miller Act payment bond protection, there is no need for Congress to go further to provide additional payment assurances to subcontractors. At the same time, without subcontractor payment bonds, prime contractors must have added flexibility in dealing with their subcontractors.

There Are No Prevailing Industry Standards For Payments Under Subcontracts And Purchase Orders

Section 7 of the proposed Prompt Payment Act Amendments will require construction contractors to pay their subcontractors and vendors in accordance with prevailing industry payment standards. However, there are no prevailing industry payment standards. The contract terms between the contractors and their subcontractors and suppliers determine when payments are to be made. Every contract is different.

Even standard form subcontract agreements do not provide uniformity in payment practices. For example, the Associated General Contractors' standard Subcontract For Building Construction provides that payments to subcontractors shall be made no later than seven days after receipt by the contractor of payment from the owner for that subcontractor's work provided the subcontractor has provided like security to that provided by the prime contrator to the owner. At the same time, the American Institute of Architects Standard Form of Subcontract provides that payments will be made to subcontractors within three working days of the date of receipt of payment by the prime contractor. Other standard forms contain other payment terms. The subcontract form being prepared by the Section of Public Contract Law of the American Bar Association intends to leave payment terms open to the negotiation of the parties.

Most of the larger construction companies have their own general forms for subcontracts and purchase orders. Vendors and subcontractors also have their own forms. These forms are often modified as part of the negotiation process leading to the subcontracts and purchase orders. In any event, those forms provide no uniformity of practice in the establishment of dates for payments. Each subcontract agreement stands on its own.

Subcontract Payments Are Not Susceptible To Standard Practices

In addition to the fact that there are no prevailing industry standards for subcontract and purchase order payments, subcontracts and purchase orders are not susceptible to the establishment of standard practices. The one unique thing about construction is that no two construction jobs are alike. Conditions from one project to the next are never the same. Subcontract conditions too are that variable.

Construction contracts normally are either lump sum or unit price in nature. Subcontract work and material purchases are normally not separately identified as separate pay items in prime construction contracts. Instead, subcontract work and material purchases are only a small part of individual prime contract prices. As a result, payments under subcontracts and purchase orders do not necessarily track with payments under prime contracts.

Normally, prime contractors are paid certain percentages of particular contract prices for work items as progress payments. The fact that, for example, 50 percent of a lump sum pipe installation work item has been completed, does not mean that the pipe supplier has completed 50 percent of his work. In fact, the supplier may have already supplied all of the pipe under his purchase order. Conversely, the pipe supplier may have provided only 25 percent of the pipe but the construction contractor has opened all of the pipe trench so that overall the pipe installation work is considered to be 50 percent complete. Regardless, a 50 percent payment to the prime contractor for the pipe installation work does not mean that the pipe supplier is entitled to payment of 50 percent of the purchase order price. The payment to the subcontractor is a matter to be resolved by the prime contractor and the subcontractor according to the terms of their subcontract.

Standard subcontract payment practices can not establish a subcontractor's entitlement to payment. Moreover, it would be an impossible task to attempt to develop and enforce standard practices. Congress is venturing too far with section 7 and its intent to establish and rely on industry standards for subcontractor payments.

Aside From Restricting The Private Contract Rights Of Prime Contractors And Subcontractors, Section 7 Will Impose Even Added Risks To Prime Construction Contractors

As a related matter, the subcontractor payments contemplated by section 7 could work some additional inequitites upon prime contractors clearly not contemplated by Congress. Subcontract work finishes in stages. For example, a foundation excavation subcontractor may complete his work two years before a building is completed. The structural concrete subcontractor may finish the concrete skeleton of that same building a year before the building is finished. Under section 7, those subcontractors would be paid after the prime contractor is paid. If the excavation subcontractor's work is found to be incomplete or deficient during the course of the concrete work, that subcontractor would probably have been paid and the prime contractor would have little or no recourse against the subcontractor. On the other hand, the government would be holding the prime contractor's performance bond guaranteeing that the prime contractor (not the subcontractor) will complete or correct the foundation subcontractor's work. The same would be true for all of the work performed by subcontractors. Section 7 therefore places further risk upon the prime contractor.

Construction Subcontracts Are Even Less Susceptible To Industry Standards Than Supply Subcontracts

It is unusual that the Prompt Payment Act Amendments should isolate construction subcontracts for special treatment regarding subcontractor payments. Construction subcontracts are more unique than supply subcontracts and purchase orders. Construction conditions differ that much more than supply contract conditions. While there is no valid basis for the government to get involved in any subcontract payments under any government contract, there is even less reason to impose by law payment provisions in construction subcontracts and purchase orders. There is no rational basis for the distinction Congress would make between supply and construction contracts by section 7 of the Prompt Payment Act Amendments of 1987.

Summary and Conclusion

In summary, section 7 of the Prompt Payment Act Amendments will have an adverse impact on construction contracting. It will disturb existing practices and procedures in the prime contractor and subcontractor relationships. It will restrict the rights of both prime contractors and subcontractors to negotiate their own subcontract agreements.

Section 7 represents a major interference by the federal government in private contract matters. Section 7 is an intrusion by the federal government into the contractual relationship between the government's contractors and its subcontractors and suppliers. It is a basic violation of the principle of privity of contract. At the same time, section 7 provides no countervailing benefit to the government or the economy.

The subcontract payment requirement of section 7 will also present administrative difficulties for the federal government. For this reason alone, the federal government should not place itself directly into private contract matters.

Finally, the payment of subcontractors is not an appropriate subject requiring remedial legislation. This is one area in which Congress should resist the temptation for overregulation. Section 7 of the Prompt Payment Act Amendments of 1987 should be stricken.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
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March 13, 1987

The Honorable Dale Bumpers
Chairman
Committee on Small Business
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In response to AGC's opposition to Section 7 of S. 328, a Senate Committee on Small Business Staff Background Paper on Prompt Pay, dated February 3, 1987, has been issued. The Staff Background Paper has also served as the basis, virtually verbatim, for a Question and Answer Paper prepared by the American Subcontractors Association (ASA) dated February 16, 1987. These papers attempt to rebut AGC's opposition to payment terms in private subcontracts on Federal construction projects. In the interest of providing Committee members with alternative counsel, below is an AGC issue-by-issue analysis of the Staff Background Paper.

Intrusion Into Private Business Practices

The Staff Background Paper advances a contradictory retort to AGC's observation that the intrusion of federally mandated subcontract payment terms is an unprecedented extension of Government regulation into the exclusive business judgment of the parties to the subcontract. The Staff paper argues that Section 7 is either no intrusion at all, or, if it is, it is only minimal. According to the paper a Federal statute could somehow prescribe mandatory payment terms and interest penalties, without at the same time invading the privity of contract, or exclusive business relations between the private parties to the subcontract.

AGC submits that this assertion ignores construction industry practices, Federal contract principles, and established Federal procurement policy.

Payment is the heart of the private subcontract. Neither general contractors nor their subcontractors bid on or perform Federal construction work for the honor of it. There is no such concept as "minimal intrusion" into private business judgments. When a general contractor undertakes a contractual obligation to bring a Federal construction project in on time and at a guaranteed price, it needs all the traditional construction project management tools that have served this vital industry so well -- including payment administration. The Government owner bargains for a single point of responsibility. There is no privity of contract between the Government and the subcontractor (Merritt v. United States, 267 US 338 (1925)). Progress payments to subcontractors are purely a private matter (Fairchild Industries, Inc. v. United States, 223 Ct Cl 315, 620 F2d 807 (1980)). Likewise, if a prime contractor defaults, neither the Government nor the new contractor on the project can force subcontractors of the defaulted contractor to perform the work at the original prices (Hedin Construction Co. v. United States, 197 Ct Cl 782, 456 F2d 1315 (1972)). Neither does the default of the subcontractor excuse contractor performance (Appeal of Lough, ASBCA 11862, 69-1 BCA 7460 (1968); Appeal of Thurmont Construction Co., ASBCA 13473, 69-1 BCA 7604 (1969)).

Existing Flow-Downs Do Not Legitimate Section 7

The Staff Paper's assertion that Section 7 is an innocuous extension of the Prompt Pay Act is misleading. Section 7 is a radical departure in kind from the Act's provisions relating to the prime contract. The Act is a declaration of policy by one of the prime contract parties -- the Government - as to how it will conduct its business with the other party -- the general contractor. Section 7 would go outside this privity -- relation of rights and duties between parties to a contract (Petrin v. United States, 90 Ct Cl 670 (1940)) -- to a separate private business relationship, the subcontract.

The assertion that the 28 flow-down clauses in the Federal Acquisition Regulations (FAR) legitimate the attempted intrusion by proponents of Section 7 into private business matters misconstrue the policy expressed in these FAR clauses. Each and every flow-down pursues one or another of broad National social, labor, economic, environmental, or fiscal policies through Federal procurement practices (see attached analysis). There is not a single flow-down that evidences a governmental policy protecting the narrow interest of a particular industry group -- such as subcontractors. The American Bar Association has recently, in fact, considered and rejected the idea that there should be a standard flow-down payment clause in Federal construction subcontracts.

Lack of Objective Demonstration of Need For Congressional Action

The Staff Paper can only cite unspecific anecdotal reports, Congressional casework, and testimony by highly partisan groups in attempting to demonstrate any compelling public need requiring such a radical shift in established procurement policy. In a related document that recapitulates much of the Staff Paper, the American Subcontractors Association (ASA) offers the following:

> "Several surveys by these groups (subcontractor associations) have shown slow pay to be the number one concern of subcontractors. In addition, a review of the mail of most Congressional offices will reveal (emphasis added) an abundance of anecdotal examples of this problem."
>
> "But regardless of the actual number (emphasis added) of cases of slow pay by Federal prime contractors, it is apparent there is a problem. A few bad apples is (sic) any barrel will spoil the lot. If you stop to think about most of our laws, they were passed to police the bad apples."

Homilies should not move national policy. Neither should unsubstantiated claims of entitlement to privileged status be allowed to establish a presumption in favor of Congressional action. Those who would remove the business autonomy of private subcontract parties in favor of a Federally mandated payment clause do so at the peril of adding yet further administrative overhead on Federal projects. Proponents of Section 7 offer no analysis of how the proposal would affect the industry. For example, if risky payment terms were foisted on general contractors, wouldn't greater subcontractor bonding be called for? And, if so, wouldn't this have a devastating effect on competition?

AGC is constrained to point out the lack of reference by proponents of Section 7 as to how the real party in interest -- the Government owner -- would be affected by this shift in procurement policy. AGC believes the proponents of Section 7 have not sought the views of Federal Construction Contract Awarding Agencies simply because existing federal policy respecting private subcontract bargaining and administration under the single contract method is firmly established for good reason.

Private Contract Procedures Are Adequate

The Staff Paper states a solicitous concern for "equitable treatment of subcontractors." The paper, however, fails to discuss why existing private contractual measures should be abandoned in favor of a Federally mandated measure. Standard form industry subcontracts not only already provide for prompt payment, but also describe a variety of private contractual remedies, including work stoppage, termination, and arbitration.

Proposed Standard Is Inadequate

Proponents of Section 7 would require a single Federally mandated payment term, set by a "prevailing industry standard." This is an inadequate standard that would invite yet further legal and administrative involvement in Federal projects. The following questions indicate the vagueness of the standard:

Industry standards prevailing where?

Is there to be one national standard, or will local market conditions be recognized?

If local market conditions were to be recognized, how would they be defined?

Might standard practices differ by type of subcontract work, size of subcontract, or other variable? If so, how would these differences be recognized by regulators?

AGC submits that these very questions demonstrate the futility of attempting to legislate private contract terms in a vital and competitive industry. Progress payments from the Government to the general contractor are not earmarked for distribution to certain subcontractors according to a Government-established percentage.

Section 7 would leave the definition of the effective statutory standard to private industry joint guidelines. Apart from questions of responsible public policy formulation, AGC must point out that insofar as it has participated in national joint guidelines with the American Subcontractors Association (ASA) and the American Specialty Contractors (ASC), AGC has intended to state guidelines -- not a national legislative mandate for all subcontracts. Also, AGC notes that private industry groups that agree to guidelines have no public lawmaking authority or intent.

As to the efficacy of adopting such guidelines, or form subcontracts, to serve as statutory standards, the following must be considered. The Staff Paper argues for a statutory rule by citing the joint guidelines on prompt payment by AGC, ASA, and ASC -- 7-days. The Staff Paper also points to the prompt pay period in the American Institute of Architects' form subcontract -- 3-days. Proponents have failed to note that ASA and ASC approve and endorse both standards. So much for relying on interested groups to set consistent national policy.

Proponents State A Presumption In Favor Of Legislation

The Staff Paper argues for Section 7, in part, because only AGC has announced opposition to the measure. The Staff Paper, and the derivative document produced by ASA, go on to make much of the support of the measure by ASA, ASC, the Coalition for Prompt Pay, and other closely allied groups. In fact, ASA seems to equate these industry groups with the "procurement community," conveniently omitting such key groups as the Office of Federal Procurement Policy, GSA, the VA, the Corps of Engineers, and OMB. More importantly, however, Congressional policy should not be moved on the basis of a mere tally of the witness list.

AGC submits that the lack of objective substance in support of Section 7 should prohibit consideration. Proponents of such sweeping change in Federal procurement policy should most assuredly be held to a much higher standard of proof.

In addition to this analysis of the specific provisions of the Staff Background Paper, AGC has also provided testimony to the Senate Committee on Small Business on February 25, 1987 which presents significant additional reasons in opposition to enactment of Section 7.

Sincerely,

Hubert Beatty

Hubert Beatty
Executive Vice President

Attachment

cc: Members of Senate Committee on Small Business

ANALYSIS OF 28 FAR FLOW-DOWN CLAUSES

The Senate Small Business Committee has issued a Sta. Background Paper that asserts that current Federal Acquisition Regulation (FAR) subcontract flow-down clauses legitimate attempts to legislate a mandatory payment clause in subcontracts on Federal contruction projects (Section 7 of S. 328). The staff background paper claims that some of the 28 current flow-down clauses "go to the very essence of performance of the construction project."

This assertion misconstrues the plain purpose and effect of the existing FAR flow-downs. Without exception, the FAR clauses at issue pursue national social, economic, environmental, and fiscal policy through Federal prime contract administration -- not the narrow interest of any one particular industry group such as subcontractors.

It also must be pointed out that the American Bar Association has recently completed a review of the FAR flow-downs in its drafting of guide clauses for subcontracts. The ABA considered a payment flow-down and decided against it. The ABA decided that essential business terms should be left to the judgment of the subcontract parties.

Following is a clause-by-clause description of the 28 FAR flow-down clauses. This description demonstrates that the policy objectives addressed in the clauses are concerned with broad national policy -- not narrow industry interest. It should also be noted that there are specific dollar threshholds and conditions of applicability for virtually every clause, so that not every clause is required in every subcontract.

Civil Rights

1. Equal Opportunity (FAR 52.222-26). This clause expresses national policy against job bias based on race, color, religion, sex, or national origin by Federal contractors and subcontractors. Those who are covered by Executive Order 11246 are required to comply with contract or subcontract clauses pledging adherence to nondiscrimination laws and implementation of specific affirmative action outreach employment policies.

2. Affirmative Action Compliance Requirements for Construction (FAR 52.222-27). This clause applies to contracts and subcontracts in excess of $10,000, and pursues the same social policy objectives described above. This is a more detailed description of specific administrative details of required affirmative action plans.

3. Affirmative Action for Special Disabled and Vietnam Era Veterans (FAR 52.222-35). Required in subcontracts of $10,000 or more, unless otherwise exempt. Pledge of nondiscrimination in employment against special disabled veterans and Vietnam Era veterans. Also, details required affirmative action measures.

4. Affirmative Action for Handicapped Workers (FAR 52.222-36). This clause is required in subcontracts in excess of $2,500, unless otherwise exempt. It requires a pledge of nondiscrimination in employment on the basis of physical or mental handicap and requires affirmative action notices.

5. Utilization of Small Business Concerns and Small Disadvantaged Business Concerns (FAR 52.219-8). Required in construction subcontracts in excess of $1,000,000 under negotiated procurements. Pursues policy that small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals have the maximum practicable opportunity to participate in Federal contracts. Also, declares policy that prime contractors establish procedures to ensure timely payment to such subcontractors. [emphasis added]

Note that the prompt payment policy is specifically declared to be a matter left to the subcontract parties.

6. Small Business and Small Disadvantaged Business Subcontracting Plan (FAR 52 219-9). Required in construction subcontracts in excess of $1,000,000 under negotiated procurements. The clause does not apply to small business concerns. It calls for a detailed set of affirmative action measures to find and accommodate small business firms.

Trade and Defense

7. Buy American Act - Construction Material (FAR 52.225-5). This clause implements the statutory preference for domestic construction materials used by contractors, subcontractors, materialmen, and suppliers in the performance of Federal construction projects.

8. Required Sources for Jewel Bearings and Related Items (FAR 52.208-1). Required if subcontract may involve items containing jewel bearings. If so, there is a required source of supply.

9. Preference for U.S.-Flag Air Carrier (FAR 52.247-63). If the subcontract may involve Government-financed international air transportation, then the clause must be included in the subcontract. The clause requires the use of U.S. air carriers for international flights, where possible.

10. Preference for Privately Owned U.S.-Flag Commercial Vessels (FAR 52.247-64). Required if subcontract may involve ocean transportation of supplies. Contractors and subcontractors are required to ship at least 50% gross tonnage of equipment, materials, or supplies obtained for Government account in privately-owned U.S.-flag commercial vessels, if such vessels are available at fair and reasonable rates.

11. Security Requirements (FAR 52.204-2). Required flow-down if subcontract involves access to confidential information.

If so, subcontractor must comply with the Department of Defense Security Agreement.

Labor/Safety

12. Utilization of Labor Surplus Area Concerns (FAR 52.220-3); and Labor Surplus Area Subcontracting Program (FAR 52.220-4). Required in subcontracts that may exceed $500,000 and offer substantial subcontracting possibilities. Requires subcontractor to take affirmative action to subcontract with labor surplus area concerns (small businesses in areas of high unemployment) -- if such subcontracting is consistent with efficient performance of the subcontract and can be accomplished at prices no higher than those attainable elsewhere.

13. Notice to the Government of Labor Disputes (FAR 52.222-1). If the contract activity is designated by the head of the contracting agency as one where such notice is required, this clause is required if a subcontract labor dispute would delay the prime contract. Clause requires subcontractor to notify prime contractor of all relevant information if an actual or potential labor dispute causes or threatens to cause delay in performance.

14. Contract Work Hours and Safety Standards Act - Overtime Compensation (FAR 52.222-4). Required in all subcontracts under construction prime contracts over $2,000 involving employment of laborers or mechanics. Requires overtime pay for work beyond 40 hours per week, and sets recordkeeping rules.

15. Accident Prevention (FAR 52.236-13). General contractor under prime contract exceeding $25,000 is responsible for any subcontractors' compliance with clause. Generally the clause requires basic OSHA safety precautions, recordkeeping requirements.

16. Hazardous Material Identification and Material Safety Data (FAR 52.223-3). Required in subcontracts involving hazardous material. Clause mandates OSHA compliance with respect to hazardous substances.

Environment

17. Clean Air and Water (FAR 52.223-2). Required in subcontracts over $100,000, or those under that amount if site or facility has been convicted of Clean Air or Water Act violations. Clause pledges compliance with the statutes.

18. Clean Air and Water Certification (FAR 52.223-1). Required if subcontract contains clause in #17 above.

Intellectual Property

19. Authorization and Consent (FAR 52.227-1). Required in subcontracts over $25,000; implied, if not included in subcontracts under that amount. Government consents to use of patented

inventions in performance of Government contract. Policy encourages maximum practical commercial use of inventions in performing contracts.

20. Notice and Assistance Regarding Patent and Copyright Infringement (FAR 52.227-2). Required in subcontracts over $25,000. Subcontractor must furnish notice of any patent or copyright infringement claim stemming from performance.

Federal Fiscal Policy

21. Audit - Sealed Bidding (FAR 52.214-26). Required in subcontracts in excess of $10,000 that are under sealed bid prime contracts expected to exceed $100,000. Permits Government audit of cost or pricing data on modifications, unless prices are based on adequate competition, catalog or market prices of commercial items sold to the public, or are set by law or regulation.

22. Subcontractor Cost or Pricing Data - Modifications - Sealed Bidding (FAR 52.214-28). Required in subcontracts expected to exceed $100,000. Requires cost or pricing data for subcontract or modifications over $100,000, unless price is based on competition, market prices, or is set by law.

23. Examination of Records by Comptroller General (FAR 52.215-1). Required in first-tier subcontracts under negotiated prime contracts exceeding $10,000 when entered into. Allows Government audit of subcontractor records.

24. Audit - Negotiation (FAR 52.215-2). Required in all subcontracts over $10,000 under negotiated prime contracts exceeding $25,000. Allows Government audit of records.

25. Subcontractor Cost or Pricing Data (FAR 52.215-24). Required in subcontracts expected to exceed $100,000 or modification expected to exceed that amount under negotiated prime contracts. Requires cost or pricing data.

26. Insurance - Work on a Government Installation (FAR 52.228-5). All subcontracts under prime contracts over $2,500, where work is performed on a Government installation. Clause refers to specific types and amounts of insurance required by Government.

27. Value Engineering - Construction (FAR 52.248-3). Required in subcontracts of $50,000, under prime contracts of $100,000 or more. Discretionary with the contractor on subcontracts under $50,000. Provides for sharing of savings resulting from more economical requirements. The clause says: "The Contractor may choose any arrangement for subcontractor value engineering incentive payments; provided, that these payments shall not reduce the Government's share of the savings resulting from the VECP."

This provision demonstrates established procurement policy of leaving the financial arrangements of the subcontract parties to private negotiation rather than Government regulation.

28. Specifications and Drawings for Construction (FAR 52.236-21). Required in all subcontracts under prime contract over $25,000. May be required in subcontracts under prime contracts under the small purchase limitations, at the Contracting Officer's discretion. Requires the prime contractor to keep copies of the drawings and specifications at the work site and allow the Contracting Officer access to them. Sets procedures for contractor and Contracting Officer handling of shop drawings.

To say that the notice flow-down of these standard project administrative practices legitimates government intrusion into the payment terms of the subcontract misconstrues standard industry practices. This is a standard Federal general condition -- not a specific item of subcontract agreement.

NASBP

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Miller and Bash
Kansas City MO

March 19, 1987

Associated General Contractors of America
Attention: David A. Johnston
1957 E. St., N.W.
Washington, DC 20006

RE: Senate Bill 328

Gentlemen:

Although this Association has no official position with respect to the captioned legislation, I am writing to express my views as to the impact on contractors of Section 7 of the captioned legislation.

While it is true that I am unable to speak from the vantage point of a surety company, I am of the opinion that the provisions of Section 7 of this bill would certainly cause surety underwriters to pause and perhaps to reconsider providing surety bonds to general or prime contractors, should they be subjected to the provisions of Section 7 of the bill, should the bill become law.

Further, it is my belief that because of the possible surety bonding complications that could or would come about as a result of Section 7, inclusion of that section, at least as drafted at present, should be carefully reconsidered, and hopefully moderated.

Sincerely,

Bruce T. Wallace

Bruce T. Wallace

BTW:cs

NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS
6931 ARLINGTON ROAD, SUITE 308, BETHESDA, MARYLAND 20814 (301) 986-4166

MAR 19 '87 14:55 P.1

To: John Sroka
National AGC
1957 E. Street, N.W.
Washington, D.C. 20006

USF&G is one of the largest writers of performance and payment bonds for construction contractors on Federal projects. Based on our understanding of the provisions of Section 7 of the amendments to the Prompt Payment Act, the requirement that subcontractors be paid in full at the completion of their portion of the work on a project would materially increase the risk and exposure of the prime contractor in the event of problems arising later when the entire project is near completion. This exposure and risk would also increase a surety's concern and could lead to restriction in the bond credit available to prime contractors. For this reason USF&G supports your efforts in objection to the bill.

From: John A. Huss
Vice President

AGC WSH UR

RCA MAR 19 1207

AGC WSH UR

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TLX 279354 AGC WSH
THE PRESIDENT OF AGC OF AMERICA
WASHINGTON DC

BT
BASED ON OUR UNDERSTANDING OF SECTION 7 IT WOULD PLACE NEW AND UNCONTROLLABLE RISKS AND LIABILITIES ON A GENERAL CONTRACTOR RELATIVE TO HIS ABILITY TO CONTROL SUBCONTRACTORS PERFORMANCE AND ASSURE SUBCONTRACTOR PAYMENTS TO SUB-CONTRACTORS. THESE NEW UNCONTROLLABLE RISKS AND LIABILITIES WILL EFFECT A SURETYS ABILITY TO BOND A GENERAL CONTRACTOR ON FEDERAL CONSTRUCTION WORK. AT A VERY MINIMUM CONGRESS HAS, IN MY VIEW, AN OBLIGATION TO CONSIDER THE IMPACT OF SECTION 7 ON THE SURETY AND BONDING INDUSTRY. WE TOO ARE AT GREAT RISK. OUR AGENCY THOMAS MCGEE AND SONS HAS BEEN IN BUSINESS SINCE 1910 AND HAS CONTINUALLY PROVIDED BONDS AND SURETY TO THE CONSTRUCTION INDUSTRY.
LARRY KAMINSKY PARTNER

NNNN
1212 EST

AGC WSH UR

NASBP

April 8, 1987

M.R. "Mac" Sullivan, Jr.
Vice-President
American Subcontractors Association
1004 Duke Street
Alexandria, VA 22314

Mac:

I took up your letter of March 31, 1987 regarding our "position" on S328, The Prompt Payments Act Amendments of 1987, with our Executive Committee.

First off, let me emphatically point out that the letter Bruce Wallace wrote to the AGC on March 19 should have in no way been construed as the official position of this Association. Bruce was crystal clear on that point. The fact that the letter was introduced into the congressional record and construed to be the position of NASBP is at best unfortunate.

For the record, I wish to reiterate the fact that this Association has no official position on S328. Furthermore, Bruce's comments were based on certain assumptions, arising out of certain scenarios which might arise should S328 become law and carry with it regulations which might change its scope. On the basis of the law as drafted none of the members of our Executive Committee felt that it would inhibit the ability of General/Prime contractors to obtain bonds.

As to our position on the merits of S328, we have none. All surety people obviously support the prompt rendering of progress payments by general contractors to subcontractors in accordance with contractual terms. The absence of prompt payments inhibits a subcontractors' ability to perform, may slow down the progress of a job and heightens the risk of default by a sub. However, there is no clear concensus within our Association on the issues brought forth in the debate over S328.

The views of our members on these issues track somewhat with the orientation of a members' book of business. Those members who represent primarily general contractors, by and large, see merit in the arguments advanced by the AGC of America. Those members with a strong subcontractor client base believe quite strongly in those arguments championed by ASA and its allies in the Prompt Pay battle. A clear mandate from the membership on this issue is, therefore, impossible to achieve without rending our Association.

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*Executive Committee

NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS
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One thing you may undoubtedly be assured of is the fact that those individual members who possess some of the passions evidenced by the proponents and opponents of S328 will undoubtedly let their views be known to their Congressmen and Senators. My sincere hope is that those of our members who express their opinions will do so on letterhead other than that of NASBP. This will eliminate the confusion and misunderstanding occasioned by Bruce's letter, which was used and construed for a purpose for which it was not intended.

I regret that we caused you chagrin and hope that you will understand that our proximity to the issues of the construction industry and the fact that we serve a diverse constituency within the industry sometimes makes it difficult, if not impossible, to arrive at a clear concensus on those arguments which sometimes divide the industry.

Very truly yours,

Jack

John J. Curtin, Jr.
President

JJCJR:jd

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NASBP

March 19, 1987

Associated General Contractors of America
Attention: David A. Johnston
1957 E. St., N.W.
Washington, DC 20006

RE: Senate Bill 328

Gentlemen:

Although this Association has no official position with respect to the captioned legislation, I am writing to express my views as to the impact on contractors of Section 7 of the captioned legislation.

While it is true that I am unable to speak from the vantage point of a surety company, I am of the opinion that the provisions of Section 7 of this bill would certainly cause surety underwriters to pause and perhaps to reconsider providing surety bonds to general or prime contractors, should they be subjected to the provisions of Section 7 of the bill, should the bill become law.

Further, it is my belief that because of the possible surety bonding complications that could or would come about as a result of Section 7, inclusion of that section, at least as drafted at present, should be carefully reconsidered, and hopefully moderated.

Sincerely,

Bruce T. Wallace

Bruce T. Wallace

BTW:cs

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THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
1957 E Street, N.W. • Washington, D.C. 20006 • (202) 393-2040 • TELEX 279 354 AGC WSH
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F. THOMAS WESTCOTT, *Treasurer* HUBERT BEATTY, *Executive Vice President*

April 7, 1987

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510-6250

Dear Senator Glenn:

AGC welcomes the opportunity to provide responses to the additional questions for the record requested in the March 25 letter from Senator Sasser. We supplement our response to these interrogatories with the attached: 1) April 2, 1987 editorial from the industry's premier trade magazine, Engineering News-Record, which flatly rejects any need for Section 7; 2) March 31, 1987 letter from the Naval Facilities Engineering Command, which denies any need for Section 7.

Mr. Chairman, proponents of Section 7 have turned proper legislative science and logic on its head -- they propose a Federal solution to a non-Federal issue for a problem which does not exist, and then argue that since a Federal solution has been proposed, a Federal problem must exist.

Some of these questions do not go to the heart of the issue at hand but rather probe areas of questionable relevance as to whether Section 7 should be enacted into law. AGC finds itself, in answering these questions, having to:

- Defend a private model subcontract published by the association
- Explain and defend its relationship with subcontractor organizations
- Give advice and counsel as to how a subcontractor could or should respond in business situations.

Throughout the discussions of Section 7 there has been an absence of focus on threshold questions. AGC would like to clearly place these threshold questions at issue and encourage Members of the Committee on Governmental Affairs to focus on them.

THE FULL SERVICE CONSTRUCTION ASSOCIATION FOR FULL SERVICE MEMBERS

Threshold Issue Number 1 - Is there a need for a Section 7? Before the government enacted a law (the Prompt Payment Act of 1982) detailing how it, as one party to the contract, would pay its prime contractors, the other party to the contract, the government took precautions to assure, through objective study by the General Accounting Office, that a slow pay problem in fact existed with such prevalence and magnitude as to require Congressional action. Yet, proponents of Section 7 would have the government dictate payment terms in a contract to which it is not a party, without any similar precautions and objective study by the General Accounting Office (GAO). In AGC's view the lack of such study, and the lack of such objective evidence of a need for Section 7, should dispose of this created issue.

In view of the existing absence of objective evidence for the Committee's consideration, AGC submitted S.328 to the Naval Facilities Engineering Command. AGC asked this agency whether a problem exists, and what will be the extent of their involvement if Section 7 is enacted. The Navy's response (attached) has been:

1. "While there are sporadic complaints by subcontractors regarding delays in receiving payment from the prime contractor, this Command is not aware of any widespread or continuing record of slow payments to subcontractors working on our construction projects." (emphasis added)

2. Section 7 will increase the administrative burden of enforcing Section 7.

3. The manner of enforcement raises serious questions for the government.

Threshold Issue Number 2 - Should the government enact a law which displaces and forecloses private business negotiations and provides an individual with that which the individual should be able to achieve through the use of reasonable business acumen?

The essence of threshold issue number 2 evolves around whether the government should serve as an agent for subcontractors, with whom the government has no legal or business relationship, to assist them in achieving private subcontract language and remedies which subcontractors have every opportunity to achieve on their own through the exercise of prudent and reasonable business skills. In AGC's view, the Federal legislative process demands more deserving issues than whether the government should act as a surrogate to compensate for some individuals' deficient business skills.

AGC recommends that the Committee on Governmental Affairs reject Section 7 of S.328 for the following reasons:

- OMB opposition to Section 7 - "The government should not impose itself in this way in the payment provisions negotiated among private firms. This provision could also lead to extensive litigation..."

- Small Business Administration opposition to Section 7 - "...from a philosophical standpoint, that we should be wary about getting the U.S. Federal Government involved in a process where we may be potentially regulating some conduct downstream" and because SBA still has "a lot of questions about what exactly the nub of the problem is and how the proposal in this particular legislation might work."

- Surety industry concerns with Section 7 because it - "...would materially increase the risk and exposure of the prime contractor...and could lead to restriction in the bond credit available to prime contractors."

- Naval Facilities Engineering Command concerns with Section 7 - "The manner of enforcement raises serious questions."

- Engineering News-Record opposition to Section 7 - "The issue is the business of business, not government."

Sincerely,

Paul Emerick

Paul Emerick
Vice President

SENATE STAFF QUESTION 1

1. A fundamental thrust of AGC's opposition to Section 7 is founded upon the assertion that it places new risks and liabilities on the prime contractor while denying the "traditional private subcontract administration tools." In your oral testimony, you emphasized that without subcontractor bonding the prime contractor must retain "all of the requisite and traditional . . . necessarily including terms of payment" to protect itself.

a. What traditional subcontract administration tools are lost under Section 7?

b. Please furnish us with examples of what you mean by "requisite and traditional procedures."

c. Is a prospective subcontractor generally aware of the terms of payment, and any other terms that deviate from industry standard forms, e.g., AGC Form 600 (Subcontract for Building Construction), prior to submitting its bid or only after submission?

AGC RESPONSE

The "fundamental thrust" of AGC's opposition to Section 7 is that Section 7 will reorder well-established risk distribution patterns of Federal projects to the ultimate detriment of both the general contractor and the Government owner. We commend the Committee to take notice of the testimony of the Office of Management and Budget and the U.S. Small Business Administration in opposition to Section 7.

Both agencies on behalf of the Federal government have voiced clear, unequivocal opposition to including Section 7 in S.328. Deputy Director, OMB, Joseph Wright at the March 19 hearing of the Committee on Governmental Affairs stated in his oral comments on Section 7, "In this one we think the Government will be getting into fairly dangerous ground without a good reason at this stage because as the Gentleman just mentioned, we have not seen any information that says that there is a problem." In his written statement he added,"...we oppose the provision which would require a payment clause in construction subcontracts governing promptness of payment and payment of interest penalties. The government should not impose itself in this way in the payment provisions negotiated among private firms. This provision could also lead to extensive litigation in the courts and Boards of Contract Appeal."

At the same hearing on March 19, Frank S. Swain, Chief Counsel for Advocacy, Small Business Administration voiced opposition to Section 7 when he stated, "And on the subcontractor issue, I am inclined to agree with Mr. Wright, from a philosophical standpoint, that we should be very wary about getting the U.S. Federal Government involved in a process where we may be potentially regulating some conduct downstream...And listening to that entire discussion, I still have a lot of questions about what exactly the nub of the problem is and how the proposal in this particular legislation might work."

AGC urges the Committee to recognize the risks and liabilities a general contractor inherits every time it awards a subcontract. Consider the following data from the Dun & Bradstreet Business Failure Record (1985 and preliminary 1986 figures). In 1986, 3,969 subcontractor firms failed, leaving $692,787,166 in total liabilities. This represents a 3.7% increase over the 3,827 subcontractor failures in 1985. The 1986 total liability figure represents a 9.2% increase over the $634,132,567 left in the wake of subcontractor failures in 1985.

Although there is a high rate of business failures both among general contractors and subcontractors, AGC strongly emphasizes that the Government is protected against general contractor failure by the Miller Act, which mandates performance and payment bonds. But, the general contractor, in the overwhelming majority of instances, cannot achieve an equivalent protection from subcontractors since most subcontractors cannot obtain bonding.

a. Section 7 would deprive the general contractor and the Government owner of at least the following essential safeguards of the prime contract agreement.

o general contractor business judgment in project management -- Section 7 would require general contractors to treat all subcontractors alike in respect of payment, even though subcontractors widely differ in quality and skill level. Under Section 7 the general contractor would be foreclosed from making sound business decisions based upon careful and essential business judgments about each respective subcontractor's particular abilities, performance prospects, construction experience, bonding ability or capacity, and financial capacity. AGC stresses that the general contractor's unfettered judgment must be exercised in the interest of advancing successful project performance, which benefits and protects all parties.

o a full complement of private subcontract negotiating tools -- Payment is the most important term of any subcontract. In subcontract negotiations, concessions may be made in any one term in exchange for some trade-off in one or another term. This process frequently reflects itself in the payment terms. The point is that any subcontract represents a balance of business judgments wrapped up in an integrated agreement. If Section 7 is allowed to interject a Federal rule into one of the most significant aspects of any private bargain -- payment -- Federal law will have circumscribed the full range of private business choices available to the prime contractor and the subcontractor.

o control over payment administration -- Payment administration is the most effective and immediate control of subcontractors' performance on a project. Section 7 would, in most instances, eliminate both retainage and withholding -- the most effective and immediate ways to assure that project problems are resolved.

Under Section 7, the necessary retainage on unbonded subcontractors would be barred. Retainage is held in private sector projects as a pre-established, negotiated term designed to assure prompt resolution of performance problems. It also provides some semblance of security to allow a general contractor to use an unbonded or unbondable subcontractor. If Section 7 is enacted, one of the results will be that general contractors will be unable to work with unbonded subcontractors and will be obliged to use only bonded subcontractors. The Section-by-Section analysis of Section 7 would allow retainage in subcontracts, but only under the method and rate established in the Federal prime contract -- which is to say, in most cases, no retainage. The Section-by-Section analysis states, "The rate of such retainage (the percentage of the progress payment due) should be not higher than the rate the Government withheld from the prime contractor." The Federal Acquisition Regulation (FAR Part 32.105 and 52.232-5) establishes a presumption against retainage. Under the current FAR provisions, retainage is only permitted after a specific finding of a contract problem. This is a commendable practice, when the payor has all the security, including bonding, the Government requires of the general contractor. It is a quite different matter at the level of private business risks encountered at the subcontract level. Lawmakers must explore the full nuance of Section 7 before putting the established order of Federal construction contract practices at risk.

Payment withholding is an additional traditional tool general contractors and subcontractors recognize to solve performance problems. This too, would be barred by Section 7. Traditionally, withholding amounts to twice the estimated cost of resolving the problem or the value of the retainage held, whichever is greater.

> If subcontractors should fall off schedule, offer substandard workmanship or material, fail to submit certified payrolls, fail to provide proof of payment, fail to pay subcontractors or suppliers, or otherwise fail to meet their obligations in any number of other areas of agreement, withholding is the most immediate way to spur resolution of the problem.

b. See "a" above. To avoid being redundant AGC used terms which those familiar with the construction process will recognize as synonymous.

c. The emphasis on timing (before or after bid) relative to subcontractor awareness of terms of payment in the subcontract proposal, leads AGC to believe that the drafter of the question does not understand the differences between award of a Government contract to a prime contractor and award of a private subcontract.

The question seems to assume that there is some equivalence between the process of awarding a Federal prime construction contract and of negotiating subcontracts on the Federal project. There isn't. For a general contractor to secure award of a Federal prime contract it must do so as the lowest responsive and responsible bidder. The prime contractor must respond to plans and the specifications word-for-word. The offer and acceptance must mirror one another. There is no opportunity for a general contractor to change one word, much less an entire clause, in responding to a Government Invitation to Bid. To do so would result in the general contractor's bid being rejected as non-responsive. "Responsiveness" is an absolute criterion.

A subcontract award, on the other hand, is a negotiated process. There are no strict terms of adherence. The subcontract is open to negotiation. The subcontracting parties are left to their best business judgment and the influence of market factors in striking their deal. Consequently it is irrelevant as to whether the subcontractor is aware before or after, since negotiation of all terms of the subcontract are open until the subcontract is agreed to by both parties.

Subcontractors obviously, have a business obligation to be aware of the terms and conditions of the project specifications and the subcontract it commits itself to. Subcontractors that come up short in this exercise of elementary business acumen are probably doomed to business failure, even with the protection of Federally mandated payment terms.

SENATE STAFF QUESTION 2

2. Mr. Sullivan, the witness for the American Subcontractors Association, stated that prime contractors currently have four ways to assure subcontractor performance: (1) careful and thorough inspection; (2) retainage; (3) bonding; and (4) retainage and bonding. He said that, if Section 7 were enacted, prime contractors would still have all four ways of assuring subcontractor performance. The Section would merely require a prime contractor to identify the reasons for, and the amounts of any appropriate reductions in the subcontractor's progress payment request, before submitting a requisition to the Government. Section 7 would only constrain a prime contractor from collecting from the Government, and then failing to disburse within seven days sums which he determined were due to the subcontractor, without incurring a late payment interest penalty. The Section-by-Section analysis of Section 7 seeks to reflect this interpretation.

a. In responding to Mr. Sullivan's statement, you disagreed with this interpretation. Would you explain why?

b. Could you suggest how Section 7, or the Section-by-Section analysis, might be modified or amplified to make clear the broad subcontract administration authorities retained by the prime contractor, prior to making application to the Government for a progress payment?

AGC RESPONSE

AGC hopes that the obverse of this question has been presented to Mr. Sullivan to defend his assertions with respect to Section 7. It is axiomatic that those who would extend Federal law to the private subcontract ought to bear the primary responsibility for showing that the proposed statute addresses a demonstrable need and does so in the most appropriate way.

It is noteworthy that there is a total lack of objective evidence to demonstrate that a substantial subcontractor payment problem exists on Federal projects. Prior to enacting the 1982 law, the Congress did not rely solely on vested interests to document the scope and severity of a prompt pay problem. A 1978 GAO report documented the problem.

AGC is not suggesting that every piece of legislation requires a GAO study. However, where the opposing sides so hotly contest the issue and when it would involve such a major change in Federal procurement policy, AGC believes a study is mandated. AGC believes the position of the Naval Facilities Engineering Command by itself, now compels rejection of Section 7.

In addition, AGC believes the prefacing statement for Question

2 incorrectly assumes that the government and the general contractor are in parallel liability positions and fails to take into account the following:

a) Government inspection and subsequent progress payment for the inspected work is made as a "contract financing payment" and does not constitute acceptance of the work represented by the payment. It is merely a payment on account.

b) Any time subsequent to such payment and prior to project final payment, the government may determine an omission or deficiency exists relative to such paid for work and then withhold funds from the general contractor pending satisfaction. The general contractor cannot withhold the same amount of funds from the subcontractor as the government held from the general contractor if the subcontractor has no payments due, or payments due are of a lesser amount.

c) If, at such time, the subcontractor cannot perform either physically or fiscally, the general contractor has no security to back up the subcontractor's contractual guarantee.

d) The government, however, has a payment and performance bond backing the general contractor's contractual guarantee.

a. I disagreed with Mr. Sullivan's assertion because it minimized or overlooked the most significant problems raised by the proposal.

The interpretation that I gave at the hearing and will restate here is that the language of Section 7 would redistribute the well-established allocation of subcontract performance risks on Federal projects. This is a major change. The risks of omissions or defects discovered after payment application would be shifted to the general contractor. It is disingenuous to say that Section 7 "merely" requires a prime contractor to identify disputes at the time of payment application.

Mr. Sullivan's simplistic interpretation failed to consider the full impact of Section 7. Under Section 7, the very immediate and effective problem-solving tools of retainage and withholding would be barred to the ultimate detriment of the project. Consider this from the Section-by-Section analysis of the proposal:

". . . the provision (Section 7) does not prohibit the prime contractor from withholding retainage from progress payments otherwise due the subcontractor upon a finding of delay or other performance not in conformity with the performance requirements of the subcontract. The rate of such retainage, (the percentage of the progress payment otherwise due) should not be higher than the rate the Government withheld from the prime contractor."

Quite simply, proponents have not been put to the inconvenience of explaining the contradiction this commentary raises in respect to traditional retainage practices. The commentary imposes a presumption against retainage, unless there is a specific finding of performance problems. In doing so, it mirrors the FAR rules (Parts 32.105 and 52.232-5) which likewise say that there shall be no retainage, unless the contracting officer makes a specific finding. This plainly contradicts standard practice of holding retainage from unbonded subcontractors, irrespective of presently identified performance problems.

Finally, Mr. Sullivan's assertions with respect to a hypothetical option of subcontractor bonding were likewise as simplistic. Bonding is an option for general contractor security only to the extent subcontractors are bondable. Any Federal intrusion into private subcontract relations that would force general contractors to require subcontractor bonding would have the effect of eliminating up to 80% of subcontractor firms that might otherwise be able to compete for work under Federal projects. If that comes to pass in Section 7, the pool of eligible subcontractors will diminish, as will subcontractor markets.

b. AGC is opposed to any extension of the Prompt Payment Act to the private subcontract for the full variety of reasons already expressed in the record. Accordingly, we will decline the invitation to tinker with the parts when the whole is an onerous and unacceptable intrusion into private relationships. We will suggest, however, that examination of the Section 7 proposal should focus on general contractor ability to manage the project both before and after applications for progress payments. The Government owner should be concerned with the end result of its construction procurement process.

SENATE STAFF QUESTION 3

3. During your testimony, you urged that if Section 7 is not deleted, it be amended to require all subcontractors to post payment and performance bonds. The sponsors of Section 7 believe that the provision leaves unimpaired a prime contractor's present discretion to require bonds from its subcontractors, when it makes good business sense to do so.

a. Isn't a prime contractor free to require performance and payment bonds from its prospective subcontractors?

b. What advantage would be gained by requiring subcontractor bonding across the board, rather than leaving it to the business judgment of the prime contractor to be exercised on a case-by-case basis?

AGC RESPONSE

If you examine my testimony, I believe you will discover that I never conceded that Section 7 should be enacted, even if it were amended. What I did say was that it was a curious attempt at "equity" that would impose a mandatory payment term without parallel bonding rules. On a positive note, AGC is heartened by the recognition in the question acknowledging that general contractor business discretion is one of the primary tools of the prime contractor under the Federal construction prime contract and that it makes "good business sense" to let him use it.

a. Of course general contractor discretion with respect to bonding is worthy of preservation, and so too is discretion with respect to payment. If proponents of Section 7 would permit themselves to acknowledge that payment terms and bonding are part of a delicate equation of risk allocation in subcontracts, they would be forced to admit that the balance is lost when a Federal law alters just one of the variables. It is Section 7 which threatens the traditional exercise of business discretion on subcontracts.

b. AGC has never contended that there would be any "advantage" to across-the-board subcontractor bonding. General contractors, however, simply are not going to undertake the significantly greater risks foisted on them by Section 7, without looking for added security against these risks. The logical way to find the added security is by bonding. But, as I have already pointed out, if Section 7 is enacted and leaves a general contractor with no recourse but bonding to protect itself against new risks and liabilities, the result will be to cause general contractors to require a greater degree of subcontractor bonding which will disqualify up to 80% of subcontractor firms that might otherwise be able to compete for work in the Federal market.

SENATE STAFF QUESTION 4

4. In your testimony, you cite an example to demonstrate why AGC believes Section 7 exposes prime contractors to unreasonable risks. In your example, a prime contractor's inspection fails to detect a deficiency in a subcontractor's work which is subsequently detected by the Government after the subcontractor has departed the job, having been paid (less any retained amounts) in conformity with Section 7. The Government looks to the prime contractor for corrective action, and because the subcontractor was not bonded, you argue that the prime contractor is unreasonably exposed.

The AGC Form 600 requires a subcontractor "to warrant its work against all deficiencies and defects in materials and/or workmanship" for the period established in the contract between the owner and the prime contractor (a flow-down provision) or, if there is no such provision in the Contract Documents, "for the period of one year from the date(s) of substantial completion of all or a designated portion of the Subcontractor's Work, or acceptance or use . . . whichever is sooner."

a. Don't such warranty provisions provide adequate protection for the prime contractor in assuring subcontractor performance, both before and after the subcontractor has been paid? If not, why not?

b. For such an after-discovered defect in advance or even a (latent defect), how would the prime contractor determine how much money to withhold to provide himself adequate protection?

AGC RESPONSE

The added parenthetical assumption "(less any retained amounts)" in the characterization of my hypothetical example demonstrates the inadequate level of analysis proponents of Section 7 have applied thus far. In my testimony, I was careful to preserve the point that retainage could not be assumed. In fact, Section 7 would bar traditional retainage and withholding practices. As previously discussed, the Committee must examine, how Section 7 will interact with the Federal Acquisition Regulation, especially Parts 32.105 and 52.232-5, to radically change established risk distribution patterns on private subcontracts on Federal projects.

AGC cannot permit the argument in the second Paragraph of Question 4 to slip by without comment. The question would have it that the warranty provision of AGC-600 is a "flow-down."

The warranty in AGC-600 is a promise from one party to the other - it does not direct one party to use a particular business judgment clause in its separate contracts with others. Of course, the warranty does measure the length of the warranty promise by reference to the time period agreed on in another document - but this incorporation by reference is emphatically not a "flow-down" and those conversant with construction contract law understand that point.

Perhaps this severe misconception of contract principles by staff explains why proponents of Section 7 mistakenly refer to 50 or so FAR flow-down clauses. The number is 28. The American Bar Association has recently written model FAR-compatible subcontract clauses - mandatory flow-down and discretionary clauses. Even the ABA did not draft a payment clause out of deference to the essential private business judgment involved.

The question also makes the following assumptions in the first paragraph which we do not accept:

1) that there was a failure in the inspection - some defects elude even the most careful inspection;

2) that Section 7 would permit retainage - it would not.

AGC also will not concede that the inability to quantify nonspecific problems at the beginning of a project necessarily leads to the conclusion that contractors should be barred from using prudent business practices to protect themselves against performance failure by subcontractors.

a. AGC must express a sense of irony in this question, which concedes the efficiency of a private model subcontract warranty clause in a document that proponents of Section 7 find wanting in so many other respects. It is axiomatic among those experienced in construction contracting that a warranty is only one of several contract remedies. The burden of enforcement is on the general contractor -- so are the considerable risks of unenforceability. The costs and administrative burden are high. Payment administration on the other hand, is the most immediate, effective way to get project problems resolved. Likewise, AGC points out that there is a parallel line of remedies available to subcontractors that range from immediate to remote in terms of effectiveness. Subcontractors that experience payment delays can stop work, terminate the project, call on the surety for intervention, compel arbitration, or go to court. Sound business practice dictates layers of remedies.

Those who would suggest that warranty enforcement is, in any way, equivalent to withholding or retainage as project problem solving tools do not understand efficient delivery of construction to the Government. Increased costs that would result from such a misconception translated into law would ultimately devolve onto the Government owner through either higher bids or diminished numbers of bidders, or both.

b. The question requires one to understand the term "after-discovered defect in advance." AGC has diligently tried, but failed to make sense of this term. AGC will, however, answer what it assumes is the question through use of an example.

Example: A piling subcontractor completes its work within the first 60 days. After a careful inspection fails to turn up any problems, the subcontractor is paid in full without reduction for retainage or withholding as required by Section 7. Then some months later, an adjacent building begins to settle because of the subcontractor's faulty work. Then, aware of the probable claims, the Government makes an unallocated reduction from progress payment applications submitted by the general contractor which include the work of other subcontractors. Under Section 7, the general contractor must pay these later subcontractors and therefore accept total financial responsibility for the piling subcontractor's failure of performance. At the same time Section 7 prevents the general contractor from exercising prudent business practices to control this liability - that is, retainage and withholding.

Under traditional practices, the general contractor has discretion to choose among bonding or retainage to insure itself against ultimate responsibility for subcontractor performance failure. If the general contractor requires the subcontractor to produce performance or payment bonds, then the bonding company bears the ultimate risk. AGC notes, however, that bonding companies have expressed serious reservations about the effect of Section 7 on general contractor bonding considerations. In a telex dated, March 19, 1987, John Huss, Vice President, U.S. Fidelity and Guaranty stated, "USF&G is one of the largest writers of performance and payment bonds for construction contractors on Federal projects. Based on our understanding of the provisions of Section 7 of the amendmens to the Prompt Payment Act, the requirement that subcontractors be paid in full at the completion of their portion of the work on a project would materially increase the risk and exposure of the prime contractor in the event of problems arising later when the entire project is near completion. This exposure and risk would also increase a surety's concern and could lead to restriction in the bond credit available to prime contractors. For this reason USF&G supports your efforts in objection to the bill."

In another telex also dated March 19, 1987 Larry Kaminsky, Partner, Thomas McGee and Sons stated in part, "Based on our understanding of Section 7 it would place new and uncontrollable risks and liabilities on a general contractor relative to his ability to control subcontractors performance and assure subcontractor payments to sub-subcontractors. These new uncontrollable risks and liabilities will effect a suretys ability to bond a general contractor on Federal construction work. At a very minimum Congress has, in my view, an obligation to consider the impact of Section 7 on the surety and bonding industry. We too are at great risk..."

Finally, in a letter dated March 19, 1987, Bruce T. Wallace, Executive Vice President, National Association of Surety Bond Producers stated, that even though his association has taken no official position on Section 7 that, "While it is true that I am unable to speak from the vantage point of a surety company, I am of the opinion that the provisions of Section 7 of this bill would certainly cause underwriters to pause and perhaps to reconsider providing surety bonds to general or prime contractors, should they be subjected to the provisions of Section 7 of the bill, should the bill become law. Further, it is my belief that because of the possible surety bonding complications that could or would come about as a result of Section 7, inclusion of that section, at least as drafted at present, should be carefully reconsidered, and hopefully moderated."

If the general contractor decides on taking the necessary retainage on the unbonded subcontractor, then it will have the security of that money until the project is finally accepted by the onwer. This is a powerful incentive for problem solving rather than litigation. Section 7 would bar this protection.

For performance problems that are discovered after a progress payment application is submitted, the general contractor has heretofore had the discretion to use withholding as a way to command immediate performance from the subcontractor. Again, Section 7 would bar withholding.

SENATE STAFF QUESTION 5

5. In developing Section 7, the sponsors were under the firm impression that payment of a subcontractor by the prime contractor within seven days after receipt of the Government's payment by the prime actually reflected the prevailing industry standard and was, therefore, used as the bill's minimum standard for the subcontract payment term. The seven-day standard is reflected in the AGC-ASA-ASC Joint Policy Statement on Prompt Payment, as well as in the AGC Form 600 model subcontract agreement. The AIA's Standard Form of Agreement Between Contractor and Subcontractor (Document A-401) provides for a three-day payment term, which exceeds the prescribed minimum standard. No where within the Joint Policy Statement or the AGC Form 600 is there an implication that the payment term applies only if the subcontractor is bonded. Yet, your statement suggests that AGC endorses equal treatment regarding payment between the prime contractor and its subcontractor only when there is "like security," i.e., the same bonding protection that exists between the Government and the prime contractor.

a. Why doesn't the AGC Form 600 clearly highlight that different payment practices will apply for bonded and unbonded subcontractors?

b. Why wasn't this issue addressed in the AGC-ASA-ASC Joint Policy Statement?

c. Do prime contractors routinely modify the AGC Form 600's provisions regarding payment when they actually contract with subcontractors from whom they have not sought performance and payment bonds?

d. If so, can you inform the Committee as to the range of payment terms likely to be found in actual subcontract agreements?

e. In light of your testimony that each subcontract agreement is virtually unique, is the concept of a "prevailing industry standard" illusory, despite the Joint Policy Statement and the AGC model agreement?

f. If so, should the Committee reconsider the seven-day standard included in Section 5 (Interest Penalties on Progress Payments and Retained Amounts Under Construction Contracts), which was derived from the same sources?

AGC RESPONSE

The drafter of the question consistently refers to the payment provision in AGC Form 600 and the Joint Policy Statement as a "standard". The drafter fails to understand the difference between a "standard", a "guideline", and a Federal law. Webster's Dictionary defines a standard as something established for use as a rule or basis of comparison. Webster's defines a guideline as a principle by which to make a judgment or determine a policy or course of action. Industry form contracts and Joint Policy Statements are guidelines, and not "standards" in the sense that they are or were meant to be legally compelling. In fact, virtually every form document published by the major document publishers bears a legend on the face of the document advising users that legal and/or insurance advice should be sought before the form is used and executed. Form subcontracts are tools to be used as a point of departure for private negotiations between the parties - the forms are not in and of themselves private agreements. Similarly, industry guidelines are principles, not inflexible rules.

AGC must also reaffirm that time of payment (proposed 7 day) is not and has not been at issue. The question also incorrectly treats "payment term", "equal treatment regarding payment" and time of payment "7 days" synonymously.

a. AGC's subcontract form (Subparagraph 5.2.2) does clearly provide for a distinction in payment terms based on bonding status. Those conversant with construction contract negotiations clearly recognize the meaning and application of 5.2.2 of AGC Form 600.

b. Again, the question probes areas of questionable relevance to the question of whether Section 7 ought to be law. Private industry guidelines or statements read the way they do for many reasons, among them discretion, judgment, compromise, etc. But, private industry guidelines are not law -- and were never intended to be law. They were meant to be guidelines -- to express principles, but not to bind individual, private business discretion.

Additionally:

1. The Joint Policy Statement on Prompt Payment, page 19 of the current jointly sponsored "Construction Industry Survival Kit" addresses the chronological order, the timeframe for preparing and processing payment requests and making of payments.

2. It does not address retainage, which is a variable directly related to risk, which varies with each project, type of work, subcontractor and if bond is furnished. Hence, neither retainage or bonds are addressed in the Joint Policy Statement.

c. I cannot describe the specifics of each and every business arrangement in the industry. I know that in my firm it is a primary element of sound subcontract bargaining practice that the range of payment term options is dictated first by bonding judgments. It is this professional judgment on the part of the general contractor with respect to evaluating subcontractor performance abilities and risks toward the ultimate successful completion of the Project that the Government purchases in the the prime contract.

d. AGC is not able to quantify responses for the Committee. Good manners, among other technical constraints, prevents AGC as an organization from probing into private business arrangements. However, AGC urges the Committee to avoid the fallacy of drawing conclusions about Section 7 based on highly attenuated lines of questioning. AGC can assert, however, that contractors and subcontractors are free to come to their own bargain governing performance.

Although AGC can not quantify the entire range of terms likely to be negotiated between a general contractor and subcontractor we do emphasize the following as conditions upon which payment terms are determined:

1. Monthly lien releases reconciled to billings.
2. Joint checks.
3. Submission of material invoices and sub-subcontractor payment requests.
4. Payroll records.
5. Weekly certified payroll reconciled to billings.
6. Retainage percentage.
7. Discount for advance payments.
8. Criteria for an extremely detailed schedule of values including the names of all suppliers and sub-subcontractors.
9. Banking line of credit certification.

e. "Standards," "guidelines," "principles," whatever word is chosen, all signify an element of free, private choice -- not legislative dictate. The terms describe common prevalent choices -- not mandatory rules. Again, the freedom to limit, accept, expand, reject, or ignore the principles in each particular circumstance based on business experience and judgment is key. The question again betrays a conceptual confusion about the proper meaning of the term "standard." "Prevailing industry standard" may denote a desirable principle, or what is the departure point for bargaining, or what most would hope to achieve. In any event, it is not law. It is not what must be. So, the term is not "illusory," it simply is not law -- as the proponents of Section 7 would like it to be.

f. AGC opposes Section 7, and only Section 7 of S.328. If the Committee were to reconsider other Sections of the proposed Amendments, AGC would hope its judgment would be based on the merits of the proposal -- not taken in retaliation for opposition to unrelated provisions. Also, as previously noted, AGC emphasizes that time of payment is not at issue. Retained amounts in relation to risk and the degree of security offsetting same is at issue.

SENATE STAFF QUESTION 6

6. AGC strongly asserts that timely payment of subcontractors is its policy and the prevailing practice of its members and most other general contractors. It implies that prime contractors have little incentive to delay payments to their subcontractors as a routine practice. Proponents of Section 7 assert that there are very real incentives for prime contractors to make untimely payments to their subs. The prime contractor can earn interest on the money during whatever time period (days, weeks, or months) he may be able to delay disbursement of all or a portion of the funds due to one or more of his subcontractors. The proponents of Section 7 assert further that most subcontract agreements, especially those based on the AGC Form 600, are biased against the subcontractor in establishing entitlement to a delayed payment and foreclose any reasonable chance to obtain interest in the event that a payment was found to be improperly delayed.

> a. Do you disagree that an unscrupulous prime contractor has both the incentive and the opportunity to improperly delay payments to its subcontractors, given the provisions of a subcontract agreement based on a standard industry model, like the AGC Form 600?
>
> b. What protections are afforded to a subcontractor by the typical subcontract agreement that would effectively deter an unscrupulous prime contractor from improperly delaying the disbursement of funds received from the Government?
>
> c. How would you respond to the testimony of Mr. Buttram, the witness representing the Associated Specialty Contractors, that the minimum standards for timely payment of subcontractors, enunciated by Section 7, will only impact those prime contractors who would choose to take funds from the Government and then improperly delay disbursement to their subcontractors?

AGC RESPONSE

AGC agrees that proponents of Section 7 make a great many unsupported assertions. AGC must emphasize that unsupported assertions should not be permitted to displace objective evidence and considered analysis as the proper underpinning of new Federal legislation.

The question betrays a lack of understanding about the proper role of the private market behavior. If there are general contractors who do business unfairly, then those general contractors should find it difficult to get subcontract bidders. If there are subcontract forms or provisions that subcontractors object to, then subcontract negotiations and/or enforcement should address those problems. Proponents of Section 7 are asking the Committee to leap from unsupported assertions to a radical Federal remedy -- without addressing the question of whether Federal intervention is appropriate or in the best interest of the Government owner.

a. I make no argument for the unscrupulous in the industry. I will tell you that scrupulous general contractors (and subcontractors also) value their reputations highly, and do business in a way that protects their good names. Fair dealing attracts harmonious and profitable business relations -- shaky dealing does not. The market governs.

We suggest that the unscrupulous will not be deterred by Section 7, just as, apparently, they are not deterred by the subcontracts they have signed with their subcontractors, subcontract remedies, and judicial enforcement. That is the very definition of the term "unscrupulous" -- to ignore business ethics, to be lawless.

Another layer of Federal regulation to protect the few subcontractors who continue to do business with the unscrupulous will likewise fail as a deterrent, but will interject a new and arbitrary Federal rule in the heart of the private business relationships of those many in the industry who consistently deal fairly with each other. It is simply bad policy to structure a new order of Federal construction project regulations around the hypothetical transgressions of a few, and to hazard the effective delivery of construction to the Government in the process. And this -- without so much as a minimum attempt at objective proof.

b. Subcontractors, of course, are free to choose those general contractors with whom they will do business. Furthermore, subcontractors are free to bargain with general contractors about each and every business judgment term in the subcontract they eventually sign.

Subcontractors can and do qualify their bids.

Subcontractors can, as promoted by subcontractor organizations, negotiate special terms and conditions including interest payments between the parties and inserted in AGC Form 600 under Special Provisions, Article 16 which specifically supsersede the standard provisions.

AGC Form 600 Section 5.2.6 permits a subcontractor to stop work due to payment failure. Such a procedure delays the project and exposes the general contractor to the most severe of penalties, namely the actual or liquidated damages suffered by the owner. It also permits the subcontractor to terminate the agreement.

AGC Form 600 6.3 permits the subcontractor to make claims for damages. Article 14 of the document permits resolution of unresolved claims and disputes by arbitration.

AGC Form 600 also permits the prevailing party to recover legal fees and costs (interest) in pursuit of remedy.

c. The question uses the curious term "minimum standards for timely payment of subcontractors," when referring to Section 7. Section 7 would require a certain, mandatory payment term in subcontracts. Granted, the meaning of that term is vague -- and will have to be defined -- most probably by Federal regulators, who, we may be certain, will be asked to address various other questions stemming from the vagueness. Enforcement requests will surely follow.

As to the assertion that only the unscrupulous will be checked, AGC asserts that this view is naive. As stated above, those who refuse to be bound by their subcontracts are no more likely to heed a Federally mandated payment term. Also, Section 7 makes no distinction on its face on applicability based on lack of scruples.

Section 7 would, in fact, impinge on all private business judgments industrywide. It will impact all general contractors and subcontractors. A contractor, in compliance with Section 7, will reduce the payment request on behalf of a subcontractor for known omissions or deficiencies. When the cause of the withheld funds is satisfied, the contractor cannot secure the funds to pay the subcontractor for said satisfaction until he has included same in the next request for payment from the government, which will be one to thirty days from date of satisfaction. He then cannot receive the funds until the payment is made from the government to the general contractor, which will be another sixty days. Therefore, the subcontractor payment for satisfaction of the required action could be as much as ninety days after completing same. Whereas if the contractor is holding the funds, release can be immediately after completing the requirement. This situation obviously adversely impacts the subcontractor.

SENATE STAFF QUESTION 7

7. AGC's various statements in opposition to Section 7 stress that the provision would unquestionably embroil the Government in disputes between the prime contractor and its subcontractors relating to performance and payment. Section 7, and its accompanying Section-by-Section analysis, sought to make explicit that its sole purpose was to prescribe the minimum standards for an adequate payment provision to be incorporated by the prime contractor in its various subcontract agreements. Judgments regarding the adequacy of a subcontractor's performance, and other matters affecting a subs entitlement to payment, remain under the exclusive control of the prime contractor. The prime contractor is merely required to make such judgments prior to making application to the Government for a progress payment. Disputes between the parties to the subcontract agreement relating to the adequacy of performance, entitlement to or the amount of payment or a late payment interest penalty, are to be resolved exclusively between them by negotiation, other means provided in the subcontract (e.g., arbitration), or recourse to state courts.

a. Could you please share with the Committee some specific examples of situations that form the basis of AGC's assertion that Section 7 will embroil the Government in performance and payment disputes?

b. By keeping funds which are the subject of a dispute between the prime contractor and a subcontractor in the hands of Government rather than the prime contractor, aren't we likely to expedite the resolution of disputes between the parties to the subcontract agreement?

AGC RESPONSE

This question exposes another essential flaw in the legislative examination of Section 7, so far. Instead of trying to parse out the likely fact of the matter from highly partisan proponents and opponents of the legislation, why not address the real party in interest. If it is Federal contract administration that is at issue, the Government Contracting Officers opinion should be sought.

By using the term "merely," the question attempts to minimize the substantial shifting of risk that Section 7 works with respect to omissions or deficiencies that become manifest after the payment application. Furthermore, the question implies that Section 7 will somehow be self-enforcing. AGC offers the following from the Section-by-Section analysis.

> "The resolution of any such performance dispute or other claim must remain subject to resolution between the

> parties to the subcontract and not be devolved upon the Government contracting officer for resolution. It should be noted, however, that Section 8(d) of the Small Business Act (15 U.S.C. 637(d)), as amended by the "Small Business and Federal Procurement Competition Enhancement Act of 1984," Public Law 98-577, would require the contracting officer to ensure compliance with the subcontract's provisions in the same manner as any other material provision of the subcontract (emphasis added).

The Section-by-Section analysis contradicts on its face the suggestion that Section 7 "merely" requires minimal involvement. We also draw your attention again to the March 31, 1987 letter from the Naval Facilities Engineering Command to AGC which delineates the extent of involvement and the problems associated with government enforcment of Section 7. Additionally, we draw your attention again to the statement by the OMB that..."we (OMB) oppose the provision which would require a payment clause in construction subcontracts governing promptness of payment and payment of interest penalties. The government should not impose itself in this way in the payment provisions negotiated among private firms. This provision could also lead to extensive litigation in the courts and Boards of Contract Appeal."

a. For example, a prime contractor, for whatever reason, did not pay a subcontractor on the 7th day after payment from the Government. On the 8th day, the subcontractor, based on the Contracting Officer's obligation to enforce Section 7, would go to the Contracting Officer seeking enforcement of the payment term. The Contracting Officer would then have an affirmative statutory obligation to go to the general contractor to investigate the complaint, determine whether the prime contractor had performed according to Section 7, and require payment. If the general contractor raises a performance problem, the Contracting Officer will be required to adjudicate that dispute, and thus embroil the Government in performance disputes between the general contractor and the subcontractor.

Another example requires the following detailed explanation for those not conversant with construction procurement.

> The Items listed in the schedule of values requested by the government to be submitted by the general contractor, upon which the percentage of completion is applied to determine a given progress payment amount, do not define the various subcontractors involved and the relative value of each, nor the value of that portion of the item performed by the general contractor's own forces. Thus, a given percentage of completion that may be certified by the government relative to a given item on the schedule for a specific progress payment request does not represent the proper percentage of completion for each component, and therefore the amount

apportioned to each component.

Hence, each subcontractor has a potential claim that he should receive the same percent of completion for his component that the government allowed for the whole of the scheduled item. This would be false on its face since the sum of like percentage applied to each component would produce an amount exceeding the total amount allowed for the item. Such a claim would be processed "in the same manner as any other material provision of the contract" and therefore inherently embroil the government in the same manner as if it had been a dispute between the subcontractor and government over the interpretation of a given specification requirement.

EXAMPLE: The schedule of values has an item entitled "HVAC". The value for this item may include work performed by, among others, the mechanical subcontractor, controls subcontractor, electrical subcontractor, boiler subcontractor, insulation subcontractor, sheetmetal subcontractor, air balancing subcontractor, and others.

Whatever percentage of completion that is certified for the HVAC item, it will not be the proper percentage of completion for the individual subcontractors. Hence, the basis of inevitable claims which will embroil the government in the dispute because of the affirmative obligation to enforce Section 7 "in the same manner as any other material provision of the contract."

Additionally, when the government withholds a sum of money from the general contractor for defective work, it does not and will not define which subcontractors are responsible for what portion of the whole.

The general contractor will necessarily arbitrarily allocate portions of the government's withheld amount from the various subcontractors. The subcontractors will inevitably claim that their withheld amount is disproportionate to their responsibility and will again file a claim to be enforced by the Contracting Officer "in the same manner as any other material provision of the contract".

EXAMPLE:

(1) July 20 the general contractor submits a progress payment #8 which includes $200,000 for a given subcontractor's work performed in the month of June.

(2) August 5 a sub-subcontractor and some employees

of the subcontractor file notice with the general contractor that the subcontractor is past due in payment obligations on work performed and for which the subcontractor had previously been paid for.

(3) August 20 the general contractor receives payment from the government for progress payment request #8.

(4) The general contractor, in the absence of any subcontractor security, then holds funds from the subcontractor's payment #8 pending the subcontractor's satisfaction of its past due obligations.

(5) Such action on the part of the general contractor is a breach of Section 7 and obligates him to pay interest on withheld funds.

(6) When progress payment #9 is submitted, the general contractor reduces the amount it had requested in #8 on behalf of the subcontactor by the amount being withheld.

(7) The government honors the request and makes payment for the reduced amount.

(8) The general contractor is no longer in breach of Section 7.

(9) The subcontractor now alleges that he has not paid his sub-subcontractor obligations because of a dispute and files a claim against the government through the general contractor for improperly withholding funds, which then would necessarily be enforced "in the same manner as any other material provision of the contract". Again, the government becomes embroiled in performance and payment disputes.

b. This question concedes involvement of the Government in subcontract performance disputes. The Government holding back funds will not provide any new incentive because the real incentive will already have been eliminated -- by displacing the most immediate remedies of withholding or retainage, Section 7 would remove subcontractor incentive for quick action and thereby impair delivery of construction to the Government.

Also, by the government withholding the funds rather than the contractor, the release of funds to the subcontractor, following resolution, will inherently be delayed a minimum of 30 more days.

SENATE STAFF QUESTION 8

8. AGC has also argued that Section 7 is unnecessary because it duplicates protections against late payments afforded by various model subcontract agreements, such as the AGC Form 600. The supporters of Section 7 argue that the AGC Form 600 agreement fails to provide protections comparable to Section 7.

a. Does the AGC Form 600 agreement assure the subcontractor a late payment interest penalty at a rate equal to that applicable between the prime contractor and the Government under the Prompt Payment Act?

b. Does the AGC Form 600 make the subcontractor's entitlement to any late payment interest penalty contingent upon the prime contractor being able to pass the cost of the interest penalty on to the Owner, i.e., the Government?

c. Do Owners in the private sector often agree to assume the cost of a prime contractor's interest penalty for an untimely payment to a subcontractor, after payment has been made by the Owner? If so, could you share with the Committee examples of the specific circumstances under which this might occur.

d. Section 7 would prohibit the prime contractor from passing along to the Government the costs of late payment interest penalties arising out of payments that failed to conform to the subcontract's payment provision. Does AGC oppose this provision of Section 7? If so, why?

AGC RESPONSE

These questions appear to rest on the assumption that there should be some equivalence between the Government owner/general contractor relationship and the general contractor/subcontractor relationship. That is, if AGC-600 is not an exact mirror of the prime contract, as Section 7 would purport to be, then Section 7 ought to become law. Nothing could be more fallacious. Quite simply, general contractors and subcontractors individual relationships with their "payors" (Government with respect to general contractors, and general contractors with respect to subcontractors) are astoundingly different. These differences logically mandate differences in the sense of security with which payments are made.

For example, in order for a general contractor to be awarded a Federal contract bid, it must meet comprehensive "responsibility" criteria. Allow us to provide the Federal Acquisition Regulation (Part 9.104-1) definition:

> "To be determined responsible, a prospective contractor must --
>
> (a) Have adequate financial resources to perform the contract, or the ability to obtain them (see 9.104-3(b));
>
> (b) Be able to comply with the required or proposed delivery or performance schedule, taking into consideration all existing commercial and governmental business commitments;
>
> (c) Have a satisfactory performance record (see 9.104-3(c));
>
> (d) Have a satisfactory record of integrity and business ethics;
>
> (e) Have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them (including, as appropriate, such elements as production control procedures, property control systems, and quality assurance measures applicable to materials to be produced or services to be performed by the prospective contractor and subcontractors)(see 9.104-3(b));
>
> (f) Have the necessary production, construction, and technical equipment and facilities, or the ability to obtain them (see 9.104-3(b)); and
>
> (g) Be otherwise qualified and eligible to receive an award under applicable laws and regulations."

In addition to meeting these requirements of responsibility, some Federal agencies will only award contracts to pre-qualified general contractors. And, by law, general contractors must also post performance and payment bonds. The aggregate result is security assurance of the general contractor on the part of the Government owner.

Subcontractors seeking work on Federal projects under private subcontracts with the general contractor, on the other hand, are not legally required to meet any of these tests. It is true that the general contractor may require performance and payment bonds from the subcontractor, but in most cases this is a false option since the overwhelming majority of subcontractors simply are not bondable. Consequently, the general contractor is left with payment administration -- retainage and withholding -- as the primary method of attempting to achieve anywhere near the semblance of security from the subcontractor that the Government owner gets from the general contractor.

a. Paragraph 5.4, Late Payment Interest, of AGC-600 provides that there shall be late payment interest on progress or final payments at the rate specified in the general contract, or legal rate at the place of the project, to the extent obtained by the Contractor. If the Prompt Payment Act covers prime construction contract progress payments, then the subcontractor would take the rate established under the Act -- if obviously, the subcontract parties were to decide in negotiation to use Paragraph 5.4 of AGC Form 600. Remember, the parties are free to structure their agreement as they see fit -- making all the various judgments, compromises, and trade-offs that make up an integrated business subcontract.

b. The subcontractor is assured late payment interest, if the Government provides such interest to the general contractor. No, if Article 16 of the Subcontract 600 states otherwise.

c. No. But, private sector owners do typically agree to pay interest to general contractors for the owner's late payments at an agreed-upon rate, or if left to the general conditions, at the legal rate at the place of the project.

d. AGC opposes each of the parts of Section 7 in the same manner and for the same reasons as we oppose the whole of Section 7. The private subcontract payment terms ought to be left to the business judgment of the subcontract parties.

SENATE STAFF QUESTION 9

9. AGC has also argued that Section 7 unnecessarily duplicates legal remedies already available. Specifically, the Miller Act is cited as providing adequate protection to subcontractors faced with delayed payments from their prime contractor during the term of on-going subcontract performance.

a. Doesn't the Miller Act prohibit a subcontractor from filing suit until 90 days after he last completed labor or supplied materials to the job site?

b. Would this require the subcontractor to quit the job to avail himself of the Miller Act remedy?

c. Does the act of quiting the job to seek redress of a delayed progress payment dispute under the Miller Act, leave the subcontractor exposed to counterclaims for delay or default by the prime contractor?

d. Would AGC support an amendment to extend the Miller Act to cover progress payment disputes between a subcontractor and a prime contractor?

AGC RESPONSE

AGC believes that Section is not needed because private subcontracts already: 1) provide for prompt payment, 2) provide for remedies. It is telling that of all the remedies available under the subcontract -- stop work, arbitration, etc. -- only the Miller Act is addressed by this question.

a. The Miller Act most definitely provides adequate and reasonable protection to a subcontractor during construction. Nothing in the Miller Act prohibits making bond claims to a contractor's surety before 90 days after a subcontractor completes labor or supplies material. The only prohibition is on filing suit. The initial remedy, which often is the most effective remedy available to a subcontractor, is to put the surety on notice of non-payment. The surety will in turn put pressure on the contractor to make payment, where no dispute exists, so the surety won't have to pay. The Miller Act, therefore, is really a two-fold remedy, with litigation only the second stage. In reality, many Miller Act claims never reach the litigation stage because a surety has no interest in incurring unnecessary litigation expenses if no dispute exists. If there are disputes or deficiencies in the work for which the subcontractor is responsible, Miller Act litigation may be required. But in that case payment to a subcontractor would be inappropriate anyway. Under Section 7, the subcontractor could receive payment and the prime contractor would be left with no comparable remedy to cure deficiencies.

b. As stated above, there is no obligation that a subcontractor stop work in order to avail itself of the benefits of a Miller Act bond. It can file notice of non-payment with the surety at any time. Of course, stopping work for non-payment is the subcontractor's most immediate and effective remedy in any event.

c. If no dispute exists over payment due or deficiencies in the work, there is no exposure to stopping work consistent with the terms of the subcontract. If disputes or deficiencies exist, payment should not be obligated anyway.

d. The Miller Act does not prohibit claims relative to progress payments. The limitation is only on filing suit and thus recognizes that during construction the better and most practical remedy is the contractural remedy of stopping work.

SENATE STAFF QUESTION 10

10. Each of the witnesses on your Panel shared with the Committee his views concerning the precedential value of current contract provisions mandated for flow-down between a prime contractor and its subcontractors on federal construction projects. The AGC's statement and its attachments vigorously assert that there is no precedential value.

The 18 February 1987 legal memorandum from King and King states: "The only areas in which the Federal Government has injected itself involving subcontractor matters involves socio-economic programs of the Federal Government." In the 13 March 1987 letter to the Chairman of the Committee on Small Business, Hubert Beatty, AGC's executive vice president said: "Each and every flow-down pursues one or another of broad National social, labor, economic, environmental, or fiscal policies . . ." During your oral testimony, you stated on several occasions that the various mandated subcontract provision address only "socio-economic, civil rights or environmental matters."

> Q. Which is the correct enunciation of AGC's position regarding the existing flow-down provisions?

AGC RESPONSE

All three statements are correct enunciations of AGC's position with respect to the flow-down clauses. They vary only in respect of their generality, not the soundness of the conclusion. Any confusion that may result from verbal quibbling over these broad characterizations of FAR flow-down clauses can be readily cleared up by reference to AGC's analysis of the clauses previously submitted for the record. That detailed analysis reveals that the clauses do not touch private business judgments that would be appropriate for negotiation between the parties.

In the absence of federal statutes or other orders, the wage rates, subcontracting plans, racial or sexual composition of the other party's work force, or other of the existing flow-down subjects would simply not be germane to business negotiations between the parties. In fact, such clauses would in some instances very likely be illegal were it not for the Federal rule. AGC notes that Senator Levin's comments on the FAR clauses at the March 19th hearing demonstrated a proper understanding of the essential national scope and public policy concerns of the existing flow-down clauses.

AGC directs attention to some significant discrepancies in the record with respect to the flow-down clauses. Proponents of Section 7 would have it that there are some 50 mandatory FAR flow-down clauses. This is plain error. AGC submits that even a cursory examination of the clauses and the FAR regulations will reveal far fewer mandatory flow-down clauses. Also, some proponents of Section 7 have noted that the American Bar Association has recently written model FAR-compatible subcontract clauses -- mandatory flow-down and discretionary clauses. The proponents have failed to point out that the ABA decided against writing a payment flow-down out of deference to the essential private business judgment involved.

SENATE STAFF QUESTION 11

11. A review of AGC Form 600 reveals several flow-through provisions with respect to a subcontractor paying its sub-subcontractors and suppliers. Section 5.1.3 (Payment Use Restriction) states: "No payment received by the subcontractor shall be used to satisfy or secure any indebtedness other than one owned by the Subcontractor to a person furnishing labor or materials for use in performing the Subcontractor's Work." Section 5.1.4 states: "The Contractor shall have the right at all times to contact the subcontractor's subcontractors and suppliers to ensure that the same are being paid by the Subcontractor for labor or materials furnished for use in performing the Subcontractor's Work."

a. These provisions seem to ignore the concept of "privity of contract," which AGC emphasizes in its arguments in opposition to Section 7. Can you explain this apparent conflict?

b. How do these flow-down provisions differ from the minimum standards for a subcontract payment provision mandated by Section 7?

c. Would AGC be opposed to similar provisions in the agreement between the prime contractor and the Government? If so, why?

AGC RESPONSE

AGC urges the Committee to ignore attempts to set up AGC-600 as a false alternative to Section 7. AGC-600 is not mandatory, and it is not the legislation at issue. Section 7 is. Conclusions about any or all of the various provisions of form subcontracts will not support conclusions in answer to the threshold question: what objective evidence is there supporting the need for new Federal regulation?

a. The quoted provisions do respect privity of contract. The two clauses express agreement by one party to the subcontract with the other subcontract party as to how the subcontractor will apply the subcontract proceeds. The second clause is a type of remedial provision, allowing the contractor to make contact outside the subcontract. The parties have made an agreement, to do certain things. Note that the general contractor has not mandated that the subcontractor use a particular payment clause and remedies in its private dealings with others.

Also one must keep in mind that the security assurances given the Government by a general contractor -- responsibility, bonding, prequalification -- are not given the general contractor by the subcontractor. Consequently, the general contractor needs remedial provisions like 5.1.3 and 5.1.4.

> For example, the general contractor is liable under the Miller Act for a double payment if he has paid the subcontractor and the subcontractor did not pay his obligations for the specified project.
>
> The government is not likewise obligated to the general contractor's obligations.
>
> It is the general contractor and not the government that is required to provide a bond to guarantee payment of the subcontractor's obligations.

The question also displays one of the primary difficulties in the debate over Section 7. The drafter of the question simply does not understand contract principles. The clauses cited in this question are not flow-downs. Neither is the warranty clause cited in Question 4 above.

b. The general contractor is liable under the Miller Act for satisfaction of the subcontractor's obligations, whether he has paid the subcontractor or not. Hence, an exposure to double payment, which frequently does occur.

In the absence of the general contractor being protected by subcontractor performance and payment bond, the general contractor, as a prudent and essential business practice, must verify the subcontractor's satisfaction of its obligations and restrict distribution of the subcontractor's payment to obligations of the subcontractor which were incurred on the general contractor's project.

This condition of payment seeks to avoid what otherwise does, in fact, happen; namely the subcontractor uses funds from the general contractor's federal project to satisfy obligations of a non-federal project, thereby forcing the general contractor on the federal project to satisfy under the Miller Act the subcontractor's obligations on the federal project and thereby incur double expense.

Section 7 denies the general contractor the freedom to so protect himself in the absense of a subcontractor bond.

c. Federal construction procurement practices already implement analogous provisions.

The government does not guarantee the general contractor's payment obligations. The government is protected by the general contractor's payment bond from any such alleged liabilities.

Under the Miller Act the general contractor does guarantee, with bond, the subcontractor payment obligation. A very significant difference.

Prompt pay problem

The congressional battle over prompt payment of prime contractors by federal agencies focuses attention on a destructive conflict within the industry: prompt payment of subcontractors by primes. The first issue is a government matter, while the second involves private business entirely. And the means for handling it are in place.

To face the issue, Jesse M. Pickett Jr., president of the American Subcontractors Association, staged a "summit meeting" of industry leaders at ASA's annual convention last week. He asked members to listen to other organization leaders "address our adversarial attitudes" (see p. 12). Dana Huestis, president of the Associated General Contractors, got directly to the prompt-pay issue that divides his group and ASA. AGC wants a law to force prompt pay by government to general contractors but does not want government interferring with its members' contracts with subs.

There is a need for legislation to force federal owners to make timely progress payments. General contractors, too often victims of careless or overly bureaucratic agencies, need recourse in law. The problem with prime contractors who fail to meet contract terms with their subs is strictly a private affair. The solution is in the industry's hands: to police itself and enforce its own standards.

ASA should not be saying, "There ought to be a law." The issue is the business of business, not government. But AGC needs to react positively to the force of subcontractors' feelings on this issue—and educate offenders in its ranks.

DEPARTMENT OF THE NAVY
NAVAL FACILITIES ENGINEERING COMMAND
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ALEXANDRIA, VA 22332-2300

0211:GLG:0470p
31 March 1987

The Associated General Contractors of America
1957 E Street, N.W.
Washington, D.C. 20006

Attn: David A. Johnston
Director, Heavy-Industrial Division

Dear Mr. Johnston:

Thank you for the materials concerning the Prompt Payment Act Amendments of 1987 (S.328) you forwarded to me by your letter of 30 March 1987. The answers to your two questions are as follows:

- While there are sporadic complaints by subcontractors regarding delays in receiving payment from the prime contractor, this Command is not aware of any widespread or continuing record of slow payments to subcontractors working on our construction projects.

- While it appears that there must be an increased administrative burden connected with the enforcement of Section 7, the extent of that burden is not clear. An analysis of Section 7 of S.328 reveals a number of potential and difficult "enforcement" issues. First, the determination of the "prevailing industry standard" may be contested. Second, the so-called "pay when paid" relationship will invite arguments regarding the extent of the subcontractor's completed work and whether the Government payment reflects that same percentage. Third, there is the question of whether a dispute between the prime and the subcontractor is legitimate; whether the prime can insitute a retention policy in making subcontractor payments; whether third party claims can reasonably be expected to be filed; and whether damages allegedly suffered by the prime or another subcontractor were, in fact, suffered. Finally, it is not clear how the Government could independently confirm that a prime's requirest for payment does not include any amount in dispute and is in accord with subcontract provisions.

The manner of enforcement raises serious questions. Section 7 of S.328 is silent. However, the Congressional Record indicates that Public Law 98-577 requires the Contracting Officer to ensure compliance with the prime's payment obligation. Past experience leads me to believe that already overtaxed Government contracting personnel, Baords of Contract Appeals, and the Courts soon will be mired down in a new category of disputes. In my opinion, a far simpler solution is available, i.e., encourage subcontractors to decline to enter into contracts with prime contractors who fail to reasonably honor the payment provisions of their subcontracts.

Sincerely,

J. M. Cowden
Deputy Commander for Contracts

Statement of

AMERICAN SUBCONTRACTORS ASSOCIATION

to the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

S.328
PROMPT PAYMENT ACT AMENDMENTS OF 1987

March 19, 1987

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
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Statement on

S.328, Prompt Payment Act Amendments of 1987

The American Subcontractors Association is a national trade association with more than 6,500 firms representing all major construction trades in 55 chapters. In addition to its individual company members, ASA represents 15 other specialty trade associations with members of their own (See Appendix A).

ASA is the only national organization that speaks exclusively for the interests of construction subcontractors. ASA is dedicated to improving general business conditions for subcontractors through unified and cooperative actions.

In a survey of subcontractors, ASA found that the most important issue facing construction subcontractors today is getting paid in a timely manner for work performed. Although concern about the nation's economy and the keen competition in the construction industry ranked high, the overwhelming majority of subcontractors participating in the survey reported that the inability to get paid in a timely manner is their most serious problem.

Many ASA members perform construction for the federal government. Sometimes they serve as prime contractors, contracting directly with the federal government. More often,

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they serve as subcontractors, dealing with the government only through a prime contractor. In both situations, these specialty trade contractors have a direct and real interest in the proper implementation and amendment of the Prompt Payment Act of 1982.

For a big business, a delay in payment may cause some consternation in the bookkeeping department, but business would go on as usual. For a small firm--the size of most construction subcontractors--however, one payment might mean the difference between survival and disaster.

The Prompt Payment Act

In 1982, Congress passed and President Reagan signed the federal Prompt Payment Act. This Act requires federal agencies to pay all bills within 30 days. Agencies failing to pay within 45 days must automatically pay interest penalties.

Since the Prompt Payment Act took effect in October 1982, the federal government's payment practices have improved measurably.

However, as with many new laws, the implementation of the Prompt Payment Act has not been perfect. Among the problems that subcontractors have faced are:

--failure of federal agencies to pay their bills on time;

--failure of agencies automatically to pay interest owed on late payments; and

--failure of agencies to notify contractors when their invoices are incorrect.

But perhaps, the most serious problems faced by construction subcontractors are:

--the claim by federal agencies that the Prompt Payment Act does not apply to construction progress payments;

--the withholding of retainage long after the job has been completed and accepted by the government; and

--the failure of prime contractors with the government to pass the benefits of the Prompt Payment Act on to their subcontractors.

S.328, Prompt Payment Act Amendments of 1987

S.328, the Prompt Payment Act Amendments of 1987, addresses all of the problems cited above. Specifically, S.328 would:

- clarify the starting point of the Act's "payment clock" by defining "receipt of invoice" and requiring the government to announce prior to contract if formal "acceptance" will take longer than five days from the date of actual delivery of goods or performance of services by the contractor;
- make explicit the Act's intent that late payment interest penalties be paid automatically and provide for increased penalties in the event that agency personnel attempt to withhold a late payment interest penalty due to a contractor;

- phase-out the fifteen day "grace period", during which the Act allows the government to pay late without incurring a late payment interest penalty;
- make explicit the Act's application to construction progress payments (as intended) and extend the Act to cover the late disbursement of amounts retained by the government during the performance of a federal construction contract, once the project has been accepted;
- clarify the Act with respect to its application to payments for the delivery of supplies or the periodic performance of services authorized under many government contracts;
- require government construction contractors to include a payment provision in their agreements with their subcontractors, which provides for payment in accordance with prevailing industry standards and requires the payment of a late payment interest penalty to the subcontractor at the same rate applicable between the prime contractor and the government, if the prime contractor does not make payment in accordance with its subcontract;

- clarify the Act to prohibit the Government from taking "early payment" discounts long after the expiration of the contractor's specified discount period;
- make explicit the Act's coverage of contractors selling to the U.S. Postal Service;
- improve the Act's reporting requirements to assure that Congress receives from OMB an accurate and complete picture of the Act's implementation by the various agencies; and
- require the implementation of the Act through the government-wide Federal Acquisition Regulation (FAR) which has been delayed four years and which GAO found was a continuing cause of many payment problems.

ASA completely supports the provisions of S.328, the Prompt Payment Act Amendments of 1987.

The remainder of this statement focuses on the two provisions which most directly impact ASA's members:

- Section 5, Interest Penalties on Progress Payments and Retained Amounts under Construction Contracts; and
- Section 7, Payment Clause for Subcontracts under Construction Contracts.

Construction Progress Payments

Both the United States Senate and the House of Representatives clearly contemplated and intended that the prompt payment and interest requirements of the Prompt Payment Act would apply to progress payments. Section 5 (Interest Penalties on Progress Payments and Retained Amounts under Construction Contracts) clarifies that the Prompt Payment Act does, indeed, cover such payments.

There were numerous references during House committee hearings, and in the reports submitted to the committee regarding this bill, to the need for such legislation to encompass progress payments as well as final payments in government contract situations. See "Hearings before a Subcommittee of the Committee on Government Operations, House of Representatives" regarding H.R.4709 (the bill that eventually evolved into the "Prompt Payment Act", Public Law 97-177 (1982)) e.g., pages 35, 151, 328-331, 336-338, etc. (United States Government Printing Office Publication 90-2470 (1982)). The operative provision is now set forth in 31 U.S.C. Sec. 3902, regarding "interest penalties" which provides in sub-part (a) that:

> "Under regulations prescribed under Sec. 3903 of this title, the head of an agency acquiring property or service from a business concern, who does not pay the concern for each complete delivered item of property or service by the required payment date, shall pay an interest penalty to the concern on the amount of the payment due . . . ." (emphasis added)

The only language that might be construed to suggest that the Prompt Payment Act only applies to final and not interim payments would be the underscored portion of the preceding quote referring to "complete delivered item of property or service." However, the rest of the statute clearly refutes such a limited construction.

In pertinent parts of the related 31 U.S.C. Sec. 3903, Congress directed that:

> "The Director of the Office of Management and Budget shall prescribe regulations to carry out Sec. 3902 of this title. The regulation shall:
>
> (1) Provide that the required payment date is:
>
> (A) the date payment is due under the contract for the item of property or service; or
>
> (B) 30 days after a proper invoice for the amount is received if a specific payment date is not established by contract;
>
> . . .
>
> (4) Provide separate required dates for a contract under which property or services provided in a series of partial execution or deliveries to the extent the contract provides for separate payments for partial execution or delivery; . . . ."
>
> (emphasis added)

That the language in Sec. 3903(4) quoted above was intended to encompass "progress payments" is clearly indicated by the House and Senate Committee reports tendered in support of the bill prior to its passage. The House of Representatives' report noted regarding this specific portion of the Act that:

> "To the extent that contracts involving a series of partial payments or executions provide for separate payments, OMB's regulations shall specify separate dates when payment is due. This provision is intended to cover situations where the government and a business concern contract for separate payment for partial deliveries or executions; for example, progress payments." (emphasis added).
>
> H. Rept. 97-461, p.14.

Similarly, the Senate Committee report noted that the same portion of the Act:

> "[D]irects the Administrator of the Office of Federal Procurement Policy to promulgate regulations concerning contracts which provide for separate payments for partial delivery or execution of property or services, requiring (1) due dates for each separate payment and (2) the payment of interest on any amount which is not paid by the due date. This provision is intended only to reach circumstances where the government and a

> contractor contract for separate payment for partial deliveries or executions; for example progress payments. It is not intended to require a partial payment or payment of interest where a contractor simply fails to meet contractual obligations and delivers only part of a contract order." (emphasis added)
>
> S. Rept. 97-302, pp. 7-8.

This legislative history makes an extremely clear and convincing argument that the statute does include progress payments and all agencies must give that intention effect in their transactions with contractors.

However, whatever the reason--budget deficits, high interest rates, inflation--cost is the performance criteria that is currently of greatest concern to the government. This has led some in the Office of Management and Budget, citing the Prompt Payment Act as a "cash management" tool, to claim that application of the Act to construction progress payments would increase the cost of federal construction by forcing agencies to pay contractors earlier than is currently the practice. By this reasoning, the government is asking the construction industry--primarily small businesses--to help finance its construction. Construction contractors are builders, not bankers. And when the government forces construction contractors to act as bankers, it will pay dearly for that service.

Late payment has forced many capable contractors to increase bids to the government in order to keep going until they are paid. Contractors do not have sufficient capital or borrowing power to cover delayed payments. Contractors, of necessity then, must recoup a portion of the negative cash flow created by late payments by increasing their prices to the government. Thus, it would seem that the government could reduce the cost of construction projects simply by paying its bills promptly.

Section 5 of S.328 clarifies that the Prompt Payment Act applies to construction progress payments. ASA strongly supports this provision.

Retainage

In order for the Prompt Payment Act to be truly effective for the construction industry, it also must mandate that interest shall be paid on retainage if the government delays payment once the project has been accepted.

Retainage is the practice of holding back a stated percentage, often as much as 10 percent, from each progress payment to be paid upon completion of either the contractor's work or completion of the entire project. For example, as the contractor completes 100 percent of each segment of the contract, he receives only 90 percent of the agreed price for such completion.

Under the Federal Acquisition Regulation, such retainage is only withheld for "cause". The FAR also states: "Upon completion of all contract requirements, retained amounts shall be paid promptly."

Section 5 (Interest Penalties on Progress Payments and Retained Amounts under Construction Contracts) of S.328, extends the 1982 Prompt Payment Act's coverage to cover the late disbursement of amounts retained by the government during the performance of a federal construction contract, once the project has been accepted by the government. ASA strongly supports this provision.

Prompt Pay for Subcontractors

As noted above, since the Prompt Payment Act took effect in October 1982, the federal government's payment practices have improved measurably.

But one thing has not improved--that is, the payment of subcontractors on federal construction.

Despite the example set by the federal government, many prime contractors have not followed suit in their dealings with subcontractors.

Subcontractors depend on the cash flow generated by payments on account to meet their payrolls and loan payments and to meet suppliers. Yet some prime contractors take 60, 90 or more days to pay their bills.

Fifty years ago the general contractor engaged to construct a building performed most of the work with his own forces, hiring craftsmen and tradesmen directly on his payroll for specialized building tasks. A system of payment grew naturally out of this arrangement: the owner paid the general contractor the amount due and the disbursement of funds to other parties, if any, was then the general contractor's responsibility.

Today, most general contractors perform only a small fraction of actual construction. On federal government projects, that percentage is usually no more than 20 percent. Instead, work is subcontracted to firms that specialize in particular fields.

Now that subcontractors provide by far the majority of onsite labor and materials, the traditional payment system is creating cash flow problems for those two and three steps down the payment process as those higher on the ladder divert funds for other business or personal uses thus delaying payment to those who actually perform the work.

The net result is that construction subcontractors and suppliers are often paid at a slower rate than the rate at which the government advances funds for a project.

Subcontractors' payment problems are perhaps more severe on federal construction projects than on private or other public work because of the exaggerated extent to which some agencies carry the principle of ignoring the existence of subcontractors in the absence of privity of contract.

Private owners are often quite mindful of the need for payment of subcontractors to assure performance and avoid liens. In addition, thirteen states have laws which designate monies paid to prime contractors as trust funds and make it a criminal offense for a prime contractor to use the portions of these funds owed to subcontractors for any purpose other than payment of the subcontractors.

Some states that received reports that subcontractors were not being paid in a timely manner after enactment of their state prompt payment laws, passed amendments to their prompt pay laws requiring prime contractors on public work to pay promptly their subcontractors or face interest penalties similar to those faced by the state if it fails to pay its bills (See Attachment B).

At the federal level, subcontractors have only two avenues to resolve the lack of payment (1) a complaint to the contracting officer about the prime contractor's failure to pay after he has certified payment; and (2) a suit against the payment bond required under the Miller Act.

Certification of Payment. Several of the civilian agencies, including the General Services Administration and the Veterans Administration, require that a prime contractor:

> ". . . prior to receiving a progress or final payment . . . shall submit to the Contracting Officer a certification that the Contractor has made payment from

> proceeds of prior payments, or that he will make timely payment from the proceeds of the progress or final payment then due him, to his subcontractors and suppliers in accordance with his contractual arrangements with them."

Although the "Certification of Payment" requirement is a step in the right direction, there is no follow-up to assure its enforcement.

Even if a subcontractor complains about lack of payment, the most a contracting officer can do is to call the prime contractor and strongly suggest that payment be made. At this point, the prime contractor can, and usually does claim that the "contractual arrangement" with his subcontractors do not require payment at that time. The contracting officer has no way of knowing otherwise.

Even if the contracting officer desires to pursue the problem, he has no effective enforcement mechanism. Although a prime contractor who signed the "certification of payment" and then failed to pay his subcontractors is, in theory, defrauding the government, it is unlikely that the Department of Justice will file suit for the simple reason that the government has not suffered a direct financial loss.

Finally, it should be noted that even the "certification of payment" protection is not available on Department of Defense jobs.

Miller Act. In lieu of granting lien rights on federal projects, Congress enacted the Miller Act which, in addition to requiring a performance bond to guarantee completion of the project, requires a payment bond. The purpose of the Miller Act payment bond is to protect final payment to persons supplying labor and material on government projects where lien rights are unavailable.

The Miller Act has not lived up to the expectations of Congress. It is too costly and time-consuming for the small subcontractor to pursue. Generally, a subcontractor or supplier will only file suit under the Miller Act, and seek to obtain payment from the surety company that issued the bond, if the prime contractor appears to be insolvent and in danger of default to the government.

Even if the subcontractor decides to file suit under the Miller Act, he can only do so after 90 days from the date on which he last performed work or supplied material. Thus, the subcontractor has no recourse under the Miller Act for periodic progress payments unless he stops work on the project--an action that, presumably, the government would want discourage.

In any event, the resulting delay in payment for months or even years can easily bankrupt a subcontractor.

Small Business and Federal Procurement Competition Enhancement Act. In 1984, Congress recognized the plight of small subcontractors in the "Small Business and Federal Procurement Competition Enhancement Act" (Public Law 98-577).

That Act states that it is:

> ". . . the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals."

Neither OFPP nor the individual agencies have taken action to implement this Act.

Thus, ASA believes it is time for Congress to take steps to assure the timely payment of the federal government's subcontractors. We believe it is time for Congress to follow the lead established by 15 states and enact legislation that would require a prime contractor on federal construction to pay its subcontractors promptly after he receives payment from the federal government or face interest penalties identical to those faced by the federal government for late payment under the Prompt Payment Act.

S.328, the Prompt Payment Act Amendments of 1987, contains such a provision. Section 7, Payment Clause for Subcontracts under Construction Contracts, requires that a prime contractor on a federal construction project include a payment clause in its subcontract agreements which meets two basic standards.

First, the payment provision must conform with "prevailing industry standards". "Prevailing industry standards" is currently deemed to be seven days after the prime contractor is paid by the government.

Second, as an enforcement mechanism, Section 7 requires the agreement between a prime contractor and a subcontractor to entitle the subcontractor to a late payment interest penalty at the same rate applicable between the prime contractor and the government, if the prime contractor fails to make payment in accordance with its subcontract's payment clause.

That is all Section 7 does!

Although at first Section 7 may be regarded as an intervention into the private contractual relationship between the general contractor and a subcontractor, a careful reading will show that the provision was drafted in a way that specifically preserves privity of contract. The government does not become a party to the subcontract or even to the mandated "prompt payment" provision. The government acquires no rights vis-a-vis the subcontractor nor does the subcontractor acquire rights vis-a-vis the govenment.

A mandatory pass-through provision of this nature is not uncommon in federal procurement. A review of the Federal Acquisition Regulation reveals an array of contract clauses currently required to be included in the subcontracts awarded by a prime contractor having a federal construction contract.

The American Bar Association's "Model FAR Compatible Fixed Price Construction Subcontract Terms" cites 28 clauses "which must be flowed down in some form under circumstances set forth in the FAR or the clause itself". These provisions address the full breadth of policy, practical and business interests of the government, including compliance with the specifications and drawings, value engineering, and government access to subcontract cost and other data, as well as various socio-economic programs.

The argument that Section 7 would draw the government into disputes between a prime contractor and its subcontractors is specious. But as noted above, the requirements of Section 7 do not impair the privity of contract between the government and the prime contractor. The resolution of disputes will remain between the prime contractor and the subcontractor, where they presently are.

As with the Prompt Payment Act's application between the prime contractor and the government, the subcontractor's entitlement to timely payment, or interest penalties for late payment, only applies when no dispute exists as to performance. The subcontractor is not entitled to payment if its performance is not in conformity with the project schedule or the government's specifications.

Similarly, the prime contractor may be entitled by its subcontract to withhold a payment for:

(1) work that is in dispute;

(2) third party claims, filed or reasonably expected to be filed;

(3) alleged damages suffered by the prime contractor or another subcontractor; or

(4) overdue subcontractor payments for labor, equipment or materials.

Under Section 7, the prime contractor remains completely free to make these determinations.

However, the prime contractor cannot collect payment from the government for the subcontractor's work and then fail to pay the subcontractor in a timely manner.

This is the heart of Section 7!

To assure equitable treatment of subcontractors, it is essential that a prime contractor identify subcontractor performance deficiencies and other claims in its application for payment, and any accompanying certificate, to the government and not request payment for amounts in dispute with the subcontractor until such dispute is resolved through negotiation, arbitration, or judicial action--that is, through whatever method is specified in the subcontract.

The money belongs to the government until it is paid to the prime contractor, and thereafter it belongs to the subcontractors and suppliers, except for that portion earned specifically by the prime contractor.

Indeed, to permit the prime contractor unlimited leeway in its determination of when payment should be made to a subcontractor for work for which the government has already paid, is to license the exercise of unreasonable leverage in the contracting process.

The federal government has every right to be concerned that subcontractors on its construction are paid in a timely manner.

The Prompt Payment Act of 1982 was enacted to alleviate the signficiant damaging effects which late government payments have on contractors, particularly small firms. The Act was intended to serve the government's needs by:

- Increasing the level of competition for government contract work by increasing the number of contractors willing to perform work on government projects;
- Decreasing the cost of government contracts by reducing the prevalent contractor practice of inflation of proposals for contracts in anticipation of slow payment; and
- Improving the quality and timeliness of government contracting performance by assuring timely payment to replenish working capital consumed in such performance by government contractors.

Unfortunately, the 1982 Act did not take into consideration the fact that subcontractors actually perform the majority of actual work on most federal construction projects.

Subcontractors are the ones first required to invest their working capital in the project and then are asked to wait the longest for their eventual payment, since payment from the government must pass through the "conduit" of the prime contractor.

Experience shows that prompt payment by the government to the prime contractor does not necessarily translate into prompt payment to the subcontractors. The fact is many prime contractors take the same short-term view that many government agencies have in paying their bills--the longer payment can be delayed the better.

Yet Section 7 carefully avoids the problem of "premature" payment to subcontractors. It only mandates pass-through of amounts actually paid by the government to the prime contractor with respect to the work actually performed and satisfactorily completed by the subcontractor. The prime contractor will be assessed an interest penalty only if it fails to make payment to its subcontractors seven days after being paid by the government.

ASA believes that seven days is sufficient time for a prime contractor to pay his subcontractors. After all, the only thing the prime contractor has to do is write a check. He already accepted the subcontractor's work before incorporating the subcontractor's billing into the contractor's billing to the federal government.

Seven days is the maximum standard for subcontractor payment used in the private sector.

The American Institute of Architects (AIA) Document A401, Standard Form of Agreement Between Contractor and Subcontractor (1978 edition), provides for such payments to be made within three days after receipt of payment by the prime contractor (See Attachment C).

The Associated General Contractors of America (AGC) Document No. 600, Subcontract for Building Construction (August 1984), provides for such payments to subcontractors within seven days after receipt of payment by the prime contractor (See Attachment D).

So does a joint policy statement of ASA, the Associated General Contractors of America, and the Associated Specialty Contractors (See Attachment E).

However, these documents do not contain an enforcement mechanism appropriate for federal construction. For example, the interest provision in the AGC Form 600 does not meet the Prompt Payment Act standard, which applies between the government and the prime contractor. Second, the Form 600 makes the subcontractor's entitlement to any late payment interest penalty from the prime contractor contingent upon the prime being able to pass such interest costs along to the owner--even when that late payment is the prime contractor's fault. Section 7 would not permit the prime contractor to pass along to the government the cost of interest incurred when it pays its subcontractors late.

As noted above, contractors are builders, not bankers. And when contractors, at any tier, are paid late, the government will pay--directly or indirectly.

When subcontractors believe they will be paid late, the prime contractor and thus the government will receive higher bids on its projects, in some cases substantially over estimate.

On projects already under contract where little can be done by the subcontractor to alleviate unanticipated expenses caused by late payments, the cost to the government may take the form of delay. A subcontractor who has lost most of his profit expectation in a job but who still has a lot of work to complete, poses another kind of problem to the government.

A subcontractor cannot be expected to work for nothing and the government gets no "bargain" when a subcontractor is precluded from earning a reasonable profit.

ASA believes that Section 7 of S.328 would end late payment to subcontractors from prime contractors who routinely pay late in order to gain a competitive edge or to increase their profits. We strongly support this provision.

Conclusion

Although the federal government's payment practices have improved measurably since implementation of the Prompt Payment Act in October 1982, ASA continues to receive reports of problems. We believe these problems would be resolved by enactment and implementation of S.328, the Prompt Payment Act Amendments of 1987.

ASA asks the Governmental Affairs Committee to act quickly on this important legislation and hopes that the full Senate and the House of Representatives will follow suit.

ASA's members and resources are available to help in whatever way is necessary to expedite passage of this legislation.

Attachment A

Members of
National Associations' Council
American Subcontractors Association

- American Architectural Manufacturers Association
- American Fire Sprinkler Association
- American Institute of Steel Construction
- Architectural Precast Association
- Association of Drilled Shaft Contractors
- Association of the Wall & Ceiling Industries - International
- Ceiling and Interior Systems Construction Association
- Concrete Sawing & Drilling Association
- Institute of the Ironworking Industry
- Insulation Contractors Association of America
- National Association of Elevator Contractors
- National Glass Association
- National Ornamental & Miscellaneous Metals Association
- National Roofing Contractors Association
- Painting and Decorating Contractors of America

Attachment B

States with
Prompt Pay Laws for Subcontractors

- Connecticut
- Florida
- Hawaii
- Louisiana
- Massachusetts
- Mississippi
- Nevada
- North Carolina
- North Dakota
- Pennsylvania
- Rhode Island
- South Dakota
- Tennessee
- Texas
- Utah

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
(703) 684-3450

Attachment C

THE AMERICAN INSTITUTE OF ARCHITECTS

AIA Document A401

SUBCONTRACT

Standard Form of Agreement Between Contractor and Subcontractor

1978 EDITION

Use with the latest edition of the appropriate AIA Documents as follows:

A101, Owner-Contractor Agreement — Stipulated Sum
A107, Abbreviated Owner-Contractor Agreement with General Conditions
A111, Owner-Contractor Agreement — Cost plus Fee
A201, General Conditions of the Contract for Construction.

THIS DOCUMENT HAS IMPORTANT LEGAL CONSEQUENCES. CONSULTATION WITH AN ATTORNEY IS ENCOURAGED WITH RESPECT TO ITS COMPLETION OR MODIFICATION

This document has been approved and endorsed by the American Subcontractors Association and the Associated Specialty Contractors, Inc.

12.4 PAYMENTS TO THE SUBCONTRACTOR

12.4.1 Unless otherwise provided in the Contract Documents, the Contractor shall pay the Subcontractor each progress payment and the final payment under this Subcontract within three working days after he receives payment from the Owner, except as provided in Subparagraph 12.4.3.

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THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

SUBCONTRACT FOR BUILDING CONSTRUCTION

5.2.5 TIME OF PAYMENT. Progress payments to the Subcontractor for satisfactory performance of the Subcontractor's Work shall be made no later than seven (7) days after receipt by the Contractor of payment from the Owner for such Subcontractor's Work.

is Agreement has important legal and insurance consequences. Consultation with an attorney and insurance consultant is encouraged w[illegible] spect to its completion or modification and particularly when used with other than AIA A201 General Conditions of the Contract for Construction August 1976 edition.

©Associated General Contractors of America

Attachment E

Joint policy statement 1: Prompt payment

Undue delays by owners, architects/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of AGC, ASA and ASC are urged to make efforts, singly or cooperatively where possible, to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month	Event
20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

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March 11, 1987

Ms. Colette Nelson
Director of Government Relations
American Subcontractors Association
1004 Duke St.
Alexandria, Va. 22314-3510

VIA: FEDERAL EXPRESS

Re: "Prompt Payment Act Amendments of 1987" (S-328)

Subject: Proposed Section 7 Regarding Application of Prompt Payment Principles to Subcontract Relationships on Government Projects

Dear Ms. Nelson:

At your request, I have reviewed the commentary prepared by King & King for the Associated General Contractors of America accompanying Mr. Harold Rosen's letter of February 18, 1987 to Mr. John W. Sroka setting forth AGC's opposition to inclusion of Section 7 in the final amendments to the Prompt Payment Act.

I enclose my comments responding to the AGC contentions and supporting inclusion of Section 7 and the application of Prompt Payment Act principles to subcontractors on federal projects. Such an extension of the Prompt Payment Act to subcontract relationships is entirely consistent with, if not necessary for, fulfillment of the legislative purpose underlying the Prompt Payment Act of 1982. Moreover, Section 7 of the proposed Amendments is not an unwarranted or unacceptable intrusion by the Federal Government into private contractual matters between government prime contractors and their subcontractors. Finally, principles of fundamental fairness support the concept that prompt Government payment relating to a sucontractor's work should be promptly passed through to him by the prime contractor upon receipt. It is not unfair or burdensome to apply essentially the same time limits and interest penalties to that stage of the payment process as apply at the prime contract level.

I trust these comments will add to the momentum supporting the amendments generally, as well as Section 7 in particular, in the face of which AGC appears to stand virtually alone in its opposition. This opposition is curious in view of AGC's joinder with American Subcontractors' Association and Associated Specialty Contractors Association in the recent "Joint Policy Statement No. 1" regarding "prompt payment". In that statement these three national trade associations, speaking for virtually every constituency in the contractor side of the business, agreed that:

> Undue delays by owners, architect/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, imposed hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.
>
> Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors' Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly.

As you know, that policy statement goes on to define the concept of "prompt" payment by specifying that the contractor should pay each subcontractor "the amount received from the owner on his account promptly but not later than seven days after receipt".

Please let me know if you wish any additional input or information from us.

Very truly yours,

HENDRICK, SPANOS & PHILLIPS

David R. Hendrick

DRH/esp
Enclosure

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· ALSO ADMITTED IN KENTUCKY AND IN OHIO

COMMENTS SUPPORTING INCLUSION OF THE PROPOSED SECTION 7 IN THE PROMPT PAYMENT ACT AMENDMENTS OF 1987

I.

INTRODUCTION

The declared purpose of the Prompt Payment Act of 1982 was to insure that contractors were paid promptly for labor, materials and services provided under contract to the federal government. Therefore, the 1982 Act stipulated certain time limitations within which such payment was to be made and provided for assessment of interest penalties on the government in the event such timely payments were not made. That Act dealt only with the prime contract relationship existing directly between the government contracting agency and the prime government contractor.

Section 7 of the currently proproposed Amendments to the Act would simply extend the analogous right to prompt payment (and correlative right to an interest penalty in the event of untimely payment) to the "subcontractors" actually performing the predominant amount of on-site work on most government projects. This represents a logical and reasonable extension of the "prompt payment" concept, and is, indeed, necessary to full realization of the practical benefits and policy objectives upon which the 1982 Act was predicated. In serving this strong and legitimate government interest while maintaining the proper independence of the government from application of such a subcontract provision, Section 7 is not unprecedented and does not constitute an unwarranted intrusion into private contractual relationships.

II.

SECTION 7 IS A LOGICAL AND NECESSARY EXTENSION OF THE PRINCIPLES UNDERLYING THE PROMPT PAYMENT ACT OF 1982

As proposed, Section 7 would mandate that all prime construction contracts awarded by a federal agency include a clause requiring the prime contractor, in turn, to include a "payment clause" in each "subcontract" entered relative to any such prime contract. That subcontract "payment clause" must obligate the prime contractor:

> (1) To pay the subcontractor promptly (as determined in accordance with the prevailing industry standards) out of amounts paid to the prime contractor by the agency for work performed by the subcontractor under that contract; and
>
> (2) To pay the subcontractor an interest penalty on amounts due in the case of each payment not made in accordance with such payment clause --
>
> > (A) For the period beginning on the day after the required payment date and ending on the date on which payment of the amount due is made; and

> (B) Computed at the most current rate of interest that has been determined by the Secretary of the Treasury for interest payments under Section 12 of the Contracts Dispute Act of 1978 (41 U.S.C. 611) and published by the Secretary in the Federal Register.

Section 7 then goes on to carefully stipulate that this payment clause does not constitute any obligation or contractual involvement by the United States relative to application and enforcement of rights under the subcontract.

The propriety of inclusion of Section 7 in the proposed Amendments must first focus on the legislative intention and objectives underlying the 1982 Act. In this regard, the legislative history makes clear the purpose of the Act was to alleviate the significant cost consequences arising out of untimely payment for work performed by contractors for the United States Government. See, U. S. Code Congressional and Administrative News, pp. 114-116. Accordingly, the Prompt Payment Act was intended to address the legitimate business needs of government contractors, especially small businesses, and thereby serve the government's own legitimate interests by:

(a) Increasing the level of competition for government contract work by increasing the number of contractors willing to perform work on government projects;

(b) Decreasing the cost of government contracts by reducing the prevalent contractor practice of inflation of proposals for government-related contracts in anticipation of slow payment; and

(c) Improving the quality and timeliness of government contracting performance by assuring timely payment to replenish working capital consumed in such performance by government contractors. *Id.*

However, full implementation of these objectives must further take into account the practical consideration that, by any measure, the vast majority of the work on any government project is actually performed by "subcontractors." Such subcontractors are at least one step removed in the payment process from the ultimate source of funds, the federal government, since payment must pass through the "conduit" of the prime contractor. The subcontractors are the ones first required to invest their working capital in the project and then are asked to wait the longest for their eventual payment.

This pragmatic consideration was not addressed in the 1982 Prompt Payment Act. Unfortunately, prompt payment by the government to the prime does not necessarily translate into prompt payments passed through to the subcontractors doing the bulk of the work. Indeed, this problem is recognized by the sponsors of the current amendments. *See*, "Introduction of S.328, the Prompt Payment Act Amendments of 1987." (*Congressional Record*, *Senate*, January 20, 1987, p. 8). Moreover, it is reinforced by recent surveys by the American Subcontractors Association confirming that the most important priority of subcontractors is timely payment for work performed. *See*, "Prompt Payment on Federal Construction, Statement of American

Subcontractors' Association to the Committee on Small Business" (United States Senate, June 19, 1986). Thus, Prompt Payment legislation addressing only the prime contract relationship falls significantly short of accomplishing the stated objectives of the Act.

Moreover, as compared with typical prime general contractors, subcontractors are more likely the "small business" entities which are hurt most by slow payment and conversely most benefited by prompt payment. Thus, again, the interests of subcontractors must be addressed in order to respond to the expressed concern of the co-sponsors of the current Amendments that the "most hard hit [by late payment problems] were the many small business government contractors, for whom the borrowing costs required to cover late government payments all too easily move a government contract from the firm's profit column to its loss column". See, "Introduction", supra, at p. 2.

Therefore, Section 7 is necessary to achievement of the stated objectives for federal prompt pay legislation and thus a proper addition to its scope.

III

"PREVAILING INDUSTRY STANDARDS" ARE SUFFICIENTLY PRECISE TO PERMIT REASONED APPLICATION OF SECTION 7

Concerning the practical applicability of the proposed Section 7, one must not lose focus of its principal thrust. Its primary purpose is to mandate a contractual interest penalty benefitting subcontractors on federal public works when payment is not made promptly in accordance with "prevailing industry standards." This is not uncommon. Indeed, a recognized standard in the industry, the AIA Document A-201 ("General Conditions of the Contract Construction") provides for assessment of interest for payments not made promptly. See subparagraph 7.8.1 and 9.5.2. Furthermore, this is substantially similar to the standard proposed for timing of construction progress payments under proposed Section 5 of the Amendments stipulating that prime government contracts must provide for the payment of interest on progress payments due "more than seven days" or a longer period if "the prevailing practice in private construction contracts is to provide such longer payment period."

Regarding prompt payment at the subcontract level, proposed Section 7 simply incorporates the similar concept of "prevailing industry standards". These standards are noted in the commentary accompanying the Amendments to require passthrough of payment by the prime contractor to the subcontractors no later than seven days after its receipt from the government. This is amply supported by not only the current version of the AIA Document A-401 ("Standard Form of Agreement Between Contractor and Subcontractor" (1978 Edition)), (see ¶ 12.4.1. requiring payment "within three working days") but also by a long history of evolution of documents produced by the Associated General Contractors of America, starting with the 1966 AGC-ASC "Standard Subcontract Agreement" (stipulating payment to the subcontractor "within seven (7) days," Article 20) through the most recent version AGC Document No. 600, "Subcontract for Building Construction" (1984) (requiring payment to subcontractor "no later than seven (7) days" after receipt by the contractor, Article 5.2.5). More recently, AGC joined with ASA and Associated Specialty Contractors in promulgation of a joint policy statement recognizing that the industry practice requires that the contractor pay each subcontractor "the amount received from the owner on his account promptly but not later than seven (7) days after receipt." Joint Policy Statement No. 1, AGC, ASA, ASC (1984). (See Attachment A).

Certainly any subcontract payment clause providing for payment within but no later than seven days after receipt by the prime would suffice within these standards. The critical element of Section 7, however, is the consequence of "interest" assessment that flows from the failure of the prime to promptly pass such payment along to the sub in accordance with the subcontract terms.

IV.

SECTION 7 IS NOT AN UNWARRANTED OR UNACCEPTABLE INTRUSION BY THE FEDERAL GOVERNMENT INTO PRIVATE CONTRACTUAL RELATIONSHIPS BETWEEN PRIME GOVERNMENT CONTRACTORS AND THEIR SUBCONTRACTORS

Quite clearly and expressly under the proposed language of Section 7, the government does not become a party to the subcontract or even to the mandated "prompt payment" provision. The government acquires no rights *vis-a-vis* the subcontractor nor does the subcontractor acquire rights *vis-a-vis* the government. Thus, there is no violation of the concept of "privity" of contract as it applies to the relationship between the prime contractor and its subcontractors.

All Section 7 does is mandate inclusion of a provision in the prime contract which requires inclusion of a prompt payment clause in subcontracts. This serves the legitimate government interests underlying the entire prompt payment principle.

It is certainly not uncommon for the federal government to legislatively or administratively impose its will upon the contracting practices between government prime contractors and their subcontractors. Indeed, this concept of government mandated subcontract provisions on federal projects underlay the entire effort of the American Bar Association, Public Contract Law Section, in devising a model "FAR-Compatible Terms for Subcontracts Under Federal Government Fixed Price Construction Contracts" which was recently approved by the ABA House of Delegates in February of 1987. As the attached "Table of Contents" to the final draft of that Model form suggests (see Attachment B), there are numerous separate contract clauses that are mandated by statute or by regulation for inclusion in subcontracts and sometimes even sub-subcontracts as well on all federal projects. Indeed, the form even provides a model "disputes" resolution provision. The adoption by the ABA of this model form was again in in the face of opposition by AGC. Indeed, this opposition was set forth in an AGC letter to Michael K. Love dated June 20, 1985, which incidentally included another memorandum by King & King (see Attachment C) identifying a selection of fifteen of these mandatory "flow-down" provisions for inclusion in subcontracts on federal projects. As that memorandum correctly notes, these mandated sucontract clauses range from "socioeconomic" purposes to other government interest areas such as "patent law", "truth in negotiations" (regarding fraudulent claims and cost and pricing matters), "labor relations", "value engineering", and other substantive areas of concern. Examination of the comprehensive list of federally mandated subcontract provisions included in the recently approved ABA Model form discloses that they variously address the full breadth of policy, practical and busines interests of the government and are not merely "socioeconomic" in nature. Thus, there are many instances in which the government has directly or indirectly influenced the "business" terms of subcontract relationships. Inclusion in government prime contracts of a clause requiring that all subcontracts include a prompt payment term would fit comfortably within this wide range of other mandated subcontract provisions serving the business as well as the public interest of the federal government.

The performance of the parties to the subcontract pursuant to payment timing clauses, such as that proposed Section 7, simply does not involve the government to any greater degree in subcontract matters than currently occurs. Thus, there is no need for concern regarding the federal governnment injecting itself into subcontract claims or disputes or direct resort by subcontractors against the government through administrative appeals, boards or courts.

V.

APPLICATION OF SECTION 7 IS NOT INCONSISTENT WITH SUBCONTRACT BONDING PRACTICES AND WOULD NOT SIGNIFICANTLY INCREASE THE PRIME CONTRACTOR'S RISK

Of course, at the prime contract level, the Miller Act (40 U.S.C. § 270a) requires the government contractor to provide payment and performance bonds. These security devices are to assure performance of its contractual obligations upstream to the owner as well as payment of its subcontractors and suppliers downstream in the contractual claim. While there is no such statutory compulsion requiring subcontractors to procure similar payment and performance bonds, they are generally available in most circumstances should the parties elect to use them. This is purely a business decision, usually at the instance of the prime contractor, which balances the additional cost of the bond against any benefit derived from reducing the risk of nonperformance.

However, this simply is not relevant to the issues raised by Section 7 of the proposed amendments. One must separate the concepts of "security" assuring future performance from the "timing" of payment for work already satisfactorily performed. There is simply no justification arising out of these bonding considerations warranting delayed or retained payment by the prime contractor to the extent that a subcontractor has performed work over which there is no dispute and for which the prime contractor has actually received payment from the government.

The issue of "security" for future performance can be dealt with in numerous ways such as requiring payment and performance bonds, requiring guarantees of performance, providing for retainage to be held until final completion. The mandated prompt payment term, on the other hand, only operates when there is no dispute regarding the subcontractor's work for which the owner has already promptly paid the prime contractor. The prime contractor's rights of additional withholding or setoff arising out of other subcontract provisions relating to defaults and breaches would operate in conjunction with the payment provisions. Exercise of such rights would not be inconsistent with the mandated clause regarding timing of undisputed payment.

VI.

SECTION 7 WILL NOT UNDULY INVOLVE THE FEDERAL GOVERNMENT IN THE ADMINISTRATION OF SUBCONTRACT PAYMENT MATTERS

The only issue of concern of the federal government raised by the proposed Section 7 is whether the prime contract in fact, includes the mandated language requiring, in turn, the payment clause in all subcontracts. Beyond that, the government has no involvement in the administration or enforcement of the subcontract payment clause requirements. Indeed, the clause expressly negates any such interest of the government in the actual application of the clause. This leaves the parties to the subcontract to resolve any resultant disputes by conventional mechanisms available for resolving issues between prime contractors and subcontractors.

The commentary accompanying the proposed Amendments notes that Section 8(d) of the Small Business Act (15 U.S.C. § 637(d)) may require a contracting officer to insure compliance with certain subcontract provisions. Nevertheless, this applies with equal force to involve the contracting officer in the enforcement of all subcontract provisions and procedures bearing upon the purpose of that Act. Consequently, inclusion of Section 7 in the Prompt Payment Act scheme would not add to the burden or the level of substantive involvement of a federal contracting officer in small business subcontract relationships beyond that already existent.

Finally, the proposed Section 7 would not unduly infringe upon the rights of the parties to a subcontract to establish the amount and entitlement to and conditions of payment. Section 7 only requires timely pass through of the government's money and all other terms are left to the parties.

VII.

SECTION 7 CAN BE ADMINISTERED CONSISTENT WITH EXISTING SUBCONTRACT PAYMENT PRACTICES

Nothing in Section 7 requires deviation from the long established method for processing of subcontractor payments with the sole exception that the amounts due are to be paid promptly within the terms of the act. The method of attribution to the various subcontractors of the amount of the payments received by the prime contractor is not changed. For example, the AIA Document A-201 ("General Conditions of the Contract for Construction" (1976)) provides a standard in requiring that the prime contractor promptly pay each subcontractor out of the amount paid by the owner on account of such subcontractor's work "the amount to which said subcontractor is entitled, reflecting the percentage actually retained, if any, from payments to the contractor on account of such subcontractor's work." Subparagraph 9.5.2.

The prime contractor's established method of aggregating subcontractor pay requests and supplier invoices and incorporating them into his own periodic pay request is not affected at all by Section 7. Neither is the method of changed apportioning to the various subcontractors the amounts received from the owner pursuant to the primes request for payment. Section 7 only obligates the prime to include a subcontract clause requiring prompt pass through of those opportunity amounts.

Moreover, Section 7 would not require "premature" final payment of any subcontractors. It would only mandate passthrough of amounts actually paid by the owner to the prime contractor with respect to the work actually performed and satisfactorily completed by the subcontractor.

VIII.

CONCLUSION

Only by extending the protection of the Act to the subcontract level can the government realize the substantial benefits set forth in the congressional findings and statement of purpose underlying the proposed Amendments. In adopting proposed Section 7 of the Amendments, Congress would be doing nothing more than applying a concept of fundamental fairness by affording the subcontractors the same rights and assurances of prompt payment as now benefit prime contractors on federal projects. Once the government has paid the prime contractor for successful performance of a subcontractor's work, the subcontractor is equally entitled to receive timely prompt payment from the prime for such work. Indeed, to permit the prime contractor unlimited leeway in its determination of when payment should be made to a subcontractor for work for which the owner has already paid, is to license the exercise of unreasonable leverage in the contracting process. This would be entirely counterproductive of the spirit and objectives of the Prompt Payment Act from the government's perspective.

Since the federal government has deemed it necessary to mandate prompt payment to the prime contractors, primes should now be required to promptly pass such payments through to the subcontractors actually performing the work. This substantial governmental interest served will far outweigh any minimal intrusions resulting on subcontracting practices for federal projects.

Joint policy statement 1: Prompt payment

Undue delays by owners, architects/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of AGC, ASA and ASC are urged to make efforts, singly or cooperatively where possible, to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month	Event
20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

Attachment "A"

NOT APPROVED or RECOMMENDED by American Bar Association or its Section of Public Contract Law. Not for public distribution.

10/11/86

Attachment "B"

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SOURCE: FINAL DRAFT (10/86) OF ABA MODEL "FAR-COMPATIBLE TERMS FOR SUBCONTRACTS UNDER FEDERAL GOVERNMENT FIXED PRICE CONSTRUCTION CONTRACTS." APPROVED BY ABA in 2/87.

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THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
1957 E Street, N.W. • Washington, D.C. 20006 • (202) 393-2040 • TWX: 710-822-9406 AGC WSH
VERNIE G. LINDSTROM, JR., *President* RICHARD E. HALL, *Senior Vice President* DANA HUESTIS, *Vice President*
WALTER K. PRIESTER, *Treasurer* HUBERT BEATTY, *Executive Vice President*

RECEIVED
JUN 21 1985
WICKWIRE
GAVIN & GIBBS, P.C.

June 20, 1985

Mr. Michael K. Love
Wickwire, Gavin & Gibbs, P.C.
Suite 400
8230 Boone Boulevard
Vienna, Virginia 22180

Dear Mike:

As explained at our April 24 meeting, AGC has great concerns regarding the involvement of the ABA in developing a standard form of subcontract for fixed-price federal construction work. As you know, we regard this effort as an intrusion by ABA into the relationship between government owners and general contractors and, similarly, an intrusion into the relationship between general contractors and subcontractors. Additionally, there has been no expressed need from any of these parties -- government owners, general contractors or subcontractors -- to have ABA develop such a form.

At an April 4 meeting of our association's President, Vernie G. Lindstrom, Jr., with ABA President John C. Shepherd and Judge Ruth Burg, Mr. Shepherd and Judge Burg indicated that the objective of ABA was not to draft an entire subcontract agreement but rather to draft contract provisions which, by virtue of the FAR, are mandated to flow-down to subcontractors.

President Lindstrom has already advised Mr. Shepherd and Judge Burg that AGC is totally opposed to any model clauses that would go beyond these mandatory "flow-down" provisions and include provisions which reflect judgmental business decisions, such as terms and conditions for payment, retention, among many others.

Our research reveals that there are fourteen mandatory "flow-down" provisions emanating from the FAR and its underlying statutes. (see attachment).

In futherance of the April 4 discussions amongst the ABA and AGC principals, we request the following:

1) That this letter, with attachment, be shared with all members of the ABA Subcontracting Committee of the State and Local Procurement Division and the Drafting Group of that Subcontracting Committee.

Attachment "C"

THE FULL SERVICE CONSTRUCTION ASSOCIATION FOR FULL SERVICE MEMBERS

Mr. Richard K. Love
Page Two
June 20, 1985

2) That AGC be advised as to whether the Drafting Group tracting Committee will, in fact, limit their efforts attached mandatory "flow-down" clauses.

We request these actions so as to gauge AGC's interest in ing in this effort or in pursuing other courses of action.

Sincerely,

John W. Sroka
Executive Director
Occupational Divisions

Attachment

cc: John C. Shepherd, President, ABA
Judge Ruth C. Burg
Vernie G. Lindstrom, Jr., President, AGC
Hubert Beatty, Executive Vice President, AGC

ATTACHMENT 1

List Of Mandatory Subcontract Flow-Down Clauses

	Clause	Program Implemented	FAR References	Conditions For Implementation
1.	Equal Opportunity	socio-economic	22.810(e) 52.222-26	contracts and subcontracts in excess of $10,000; contracts not otherwise exem by terms of Executive Orde 11246
2.	Affirmative Action Compliance Requirements For Construction	socio-economic	22.810(f) 52.222-27	contracts in excess of $10,0 contracts inclu Equal Opportuni clause
3.	Affirmative Action For Special Disabled and Vietnam Era Veterans	socio-economic	22.1308 52.222-35	contracts in excess of $10,0
4.	Affirmative Action For Handicapped Workers	socio-economic	22.1408 52.222-36	contracts in excess of $2,5
5.	Clean Air and Water	environment	23.105(b) 52.223-2	contracts in excess of $100 unless facilit is on EPA List of Violating Facilities
6.	Clean Air and Water Certification	environment	23.105(a) 52.223-1	contracts containing Cle Air and Water clause

	Clause	Program Implemented	FAR References	Conditions For Implementation
7.	Authorization and Consent	patents	27.201-2 52.227-1	contracts in excess of $25,000
8.	Notice and Assistance Regarding Patent and Copyright Infringement	patents	27.202-2 52.227-2	contracts in excess of $25,000
9.	Audit-Sealed Bidding	truth-in-negotiations	14.201-7(a) 52.214-26	contracts in excess of $100,000 and subcontracts in excess of $10,000
10.	Subcontractor Cost or Pricing Data-Modifications-Sealed Bidding	truth-in-negotiations	14.201-7(c) 52.214-28	subcontracts in excess of $100,000
11.	Specifications and Drawings for Construction	special construction	36.521 52.236-21	contracts in excess of $25,000
12.	Notice to the Government of Labor Disputes	labor*	22.103-5 22.101-1(e) 52.222-1	when head of contracting activity determines necessity for notification of potential or actual labor dispute
13.	Insurance-Work on a Government Installation	insurance	28.310 52.228-5	for contracts involving work on a government installation
14.	Buy American Act-Construction Materials	buy-America**	25.205 52.225-5	

	Clause	Program Implemented	FAR References	Conditions For Implementation
15.	Value Engineering-Construction	value-engineering**	48.202 52.248-3	contracts in excess of $100,000 and subcontracts in excess of $50,000

* At the present time, this the only labor related provision in the FAR that requires a mandatory flow down clause. However, FAR Part 22.4 has been reserved to implement labor standard statutes and the section is being drafted now and will undoubtedly add some mandatory flow-down provisions.

** Specific working of subcontract clause is not prescribed. However, some subcontract coverage is mandatory.

March 19, 1987

Subcontractors
Talk about
Slow Pay on Federal Construction

The Associated General Contractors of America has emphasized that Section 7 (Payment Clause for Subcontracts under Construction Contracts) of S.328, the Prompt Payment Act Amendments of 1987, is not worthy of even consideration by the United States Senate because the problem of late payments is an illusionary one. AGC maintains that the only reason that subcontractors experience late payments is because the government has failed to make timely payments to the prime contractor.

To document the problems being confronted by construction subcontractors and to, lay to rest AGC's argument that prime contractors do not delay payment to subcontractors, we have compiled excerpts from communications to ASA in which subcontractors share their very real problems in their own words.

* * * * *

Alaska

We recently did work at Eielson Air Force Base. Our pay lagged 60 to 90 days from the time the general contractor was paid, and ours wasn't the only incidence of this abuse. We complained several times to the Corps of Engineers, but since we were subcontractors, they could do nothing.

Lawrence M. Slay, Jr.
Acme Electric Company, Inc.
Fairbanks, Alaska

In 1984, I did a $22,000 job on Elmendorf. I got paid $10,000. The balance of $12,000 has never been paid. The Base officials said, "The general contracor has been paid; we cannot help you!"

Marie Wilson
Warning Lites of Alaska, Inc.
Anchorage, Alaska

I am a subcontractor doing a gross annual business between $300,000 and $900,000 of which approximately 90% is on public work and has been for ten years. Since mid-1985, I have had over $300,000 of contracts where general contractors did not pay me within 60 days after receipt of monies from the Government.

James G. Marson
J.G. Marson Mosaic & Tile
Anchorage, Alaska

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
(703) 684-3450

Arizona

I estimate that I have lost in the neighborhood of $330,000 due to "no pay" by general contractors since I began my business in 1953. The losses due to slow pay are even higher. Twenty percent of my time plus ten percent of two other people's time is spent in collections. I have had to borrow money many times--paying as much as 23.5 percent interest while having as much as $350,000 outstanding in uncollectable receivables.

A good example of slow pay occurred on a recent job for the U.S. Air Force. I received one-half of my retention only after a significant delay. Whenever I checked, the general contractor told me he had not yet been paid. Yet the check stub that was accidentally included with my payment showed he had received full payment 37 days earlier. I believe this kind of delay is standard practice among general contractors.

A.L. McCune
A.L. McCune Dry Wall Company, Inc.
Tucson, Arizona

Arkansas

During the last year, I have worked on two projects for the U.S. Postal Service. On one project, I have been owned $22,000 for nearly nine months. On the second, I have been owed over $6,000 for four months. In both cases, the prime contractor has been paid.

Dan Billingsley
Tile Center, Inc.
Benton, Arkansas

Florida

The ability to manage cash flow in a company becomes very difficult when a contractor, who has been paid, does not pay his or her subcontractors promptly. Money tied up in labor and material costs sits idle and cannot be invested in future projects. Progress grinds to a halt and your business associates begin to look elsewhere for their needs.

Samuel B. Sasser
Sasser's Glass Works, Inc.
West Palm Beach, Florida

Florida

As a subcontractor who has worked on numerous federal jobs, we have experienced the hardships caused by the lack of our cash flow brought on by the prime contractor, who while having received payment for our work, has not paid us. Routinely, prime contractors collect for a subcontractor's work he certifies to the government as complete, but withholds the monies due the subcontractor claiming his lack of performance. In addition to the hardship caused the subcontractor, the prime contractor is unjustly enriched from the use of the subcontractor's money. Often the prime contractor will drag out such payments to the subcontractor for as long as three to six months.

Hugh Munnell
Brown Automatic Sprinklers, Inc.
Tampa, Florida

Georgia

In January 1985, our firm contracted with a subcontractor for work to be performed at the Maxwell Air Force Base Area Exchange in Alabama. In other words, we were a sub-subcontractor on the job. In September 1986, not having received payment for our last three invoices ($5892.85) or our retainage ($1666.15), I wrote to the Army & Air Force Exchange Service requesting information on the project, including whether the gneral contractor had been paid. The only response was a letter with a routine recitation of my rights under the Miller Act. Nonetheless, it is my understanding, that the general contractor on this project was, indeed, paid. But the subcontractor, and thus our company, has not been paid. It is my personal belief that the subcontractor payment language being considered by the Senate would go a long way toward ending this kind of routine non-payment by general contractors.

Jack M. Cherry
Columbus Automatic Door, Inc.
Columbus, Georgia

Louisiana

In one Department of Defense job in our area, the prime contractor left over $1,000,000 in retainage on the job. Because of front-end loading, the prime had collected all his money from the job by that time; the remaining $1,000,000 was for work performed by the various subcontractors. Obviously, these subcontractors were never paid.

Russell Stratton
Stratton, Inc.
Lake Charles, Louisiana

Maryland

As a subcontractor (many times a sub-subcontractor) on government projects, we have experienced payment delays even though the general contractor has been paid. Prompt payment assures a good working relationship between all parties. The owner and all parties involved may suffer time delays, increased overhead and poor workmanship if this relationship breaks down. Competition may also be limited due to subcontractors reluctance to bid these jobs because of payment.

Allan L. Baggott
Controls Systems Sales, Inc.
Laurel, Maryland

Maine

Our company frequently does military contracting work. We, however, have had to adopt a policy of no subcontracting except to companies in-state with whom we already do non-military work. This is because we have been taken so many times by so many military prime contractors. We have no protection, as a practical matter, under the law. The federal government's payment policies permit the large prime contractor to abuse his subs if he so desires. We should not allow the fox to care for the chickens.

Chris Wetherall
Industrial Vacuum Company
Portland, Maine

Maine energy is leaning away from bidding on government jobs due to the fact of late payments. We are not alone in this area; therefore, it takes the competition bidding away from government jobs. This leaves the bidding up to contractors that are geared up for long legal battles to collect the balance of payments due.

Arthur W. Peabody, Sr.
Maine Energy, Inc.
Bangor, Maine

Michigan

We are a small firm so when prime contractors do not pay us, we cannot pay our suppliers which creates a big problem when we need credit, bonding, etc. Our company personally has had trouble collecting money on time and I am sure all subcontractors have had the same problem.

Norman VanWormer
Bay Line Fire Protection, Inc.
Pinconning, Michigan

Mississippi

Eighty percent of all construction today is done by subcontractors. They buy the materials, make the payrolls and do the work. Some of the general contractors make a practice of not paying their subs for a period of 60 to 90 days. Meantime, they have been paid the money and are using it for their own purposes. This money was earned by the subs and rightfully belongs to them. Of course, the general is entitled to his mark up, but by the same token, the subcontractor is entitled to his money.

Small businesses like us are suffering because contractors are withholding payment for six months or longer. For instance, one contractor still owes Trinity Materials, Inc. for materials supplied on a job at Keesler Air Force Base over eight months ago. Another company has already been paid by the government for completion of his contract, but is more than a month behind in paying for material we provided to him.

R. Norman Bailey
Trinity Materials, Inc.
Hattiesburg, Mississippi

The problem of late payment from prime contractors on federal construction is a serious one. As you can see from the computer print out of our aged trial balances on federal construction, on 12 separate projects, my company has balances outstanding of $44,435.74 over 30 days, $15,610.90 over 60 days, $52,570.14, and $12,029.45 more than 120 days.

T.C. Morgan
Sharp Electric, Inc.
Gulfport, Mississippi

Mississippi

As you can see from the following history on a Department of Navy Project in Kings Bay, Georgia, payment has been erratic and untimely:

Date	Invoice/ Payment	Current	Over 30 Days	Over 60 Days	Over 90 Days
5/15	$374,078	$374,078	---	---	---
6/18	93,274	93,274	$374,078	---	---
6/21	336,670	93,274	37,408	---	---
7/11	37,408	93,274	---	---	---
7/17	21,278	21,278	93,274	---	---
8/05	73,884	21,278	19,390	---	---
8/20	17,976	---	21,278	$ 1,414	---
8/23	185,774	185,774	21,278	1,414	---
9/05	37	185,811	21,278	1,414	---
9/09	21,278	185,811	1,414	---	---
9/12	428,454	428,454	185,811	1,414	---
10/09	185,445	428,454	1,780	---	---
10/29	392,452	---	37,782	---	---
12/16	87,672	87,672	---	37,782	---
1/13	72,397	---	53,057	---	---
2/17	7,548	7,548	---	53,057	---
3/20	42,507	---	7,548	---	$10,550

Without prompt pay for subcontractors legislation, it is pretty obvious that general contractors will continue to hide behind the shield of our federal government and continue with industry-wide poor payment practices.

Lawrence A. Cox
Steel Service Corporation
Jackson, Mississippi

New Mexico

We were a sub-subcontractor on a Department of Energy job. I had done business with the subcontractor with whom I contracted before and had always been paid promptly. But the general contractor on the job was from out-of-state. Pay was at least 30 days late from the very beginning of the job because the subcontractor was not being paid by the general contractor. For example, we invoiced in August for payment in September, but would not receive payment until October. We were told, "You just have to get along; this is the way it's going to be." Both the subcontractor and I contacted the general contractor but did not get an acceptable answer. The contracting officer refused to talk to us because we did not have "privity of contract". We completed our work on the job in February 1986 and submitted our request for retainage ($5,000). The building was occupied in April 1986. I was finally paid my retainage in June 1986.

Rusty Arrighetti
The Mayhew Company
Albuquerque, New Mexico

New York

Many prime contractors use the argument that payments to subs are sometimes delayed because of poor performance. However, if full payment has not been earned by a subcontractor because of poor performance, the prime contractor should not certify the completion of such work in his billing to the government. Thus, the government, not the prime contractor, should be holding all unearned payments until they have been earned.

Floyd Warkol
Warkol Mechanical Corporation
Bronx, New York

North Carolina

The standard contract that a subcontractor signs with a prime contractor often states that the subcontractor will be paid when the prime is paid. The contract does not specify the amount of time in which the prime must pay the subcontractor after he has been paid. This leaves the door open for the prime to hold monies due the subcontractor. In the meantime, material invoices may (and generally do) become past due and begin collecting interest penalties. The burden of the interest penalties fall back to the subcontractor, not the prime. This results in loss of profits to the subcontractor.

Philip J. Samuels
All Interior Supply, Inc.
Charlotte, North Carolina

North Carolina

David Allen Company entered into a $554,970 contract with a prime contractor for installation of our product in constructing a federal building project composed of three buildings in downtown Savannah, Georgia, owned by the General Services Administration.

For a number of months, every pay request was reduced while the prime contractor's project manager was concurrently submitting larger pay requests to GSA and falsely certifying that David Allen was being paid per the prime contractors own payments from GSA. No payment was made on the final two monthly billings. That is, the prime contractor collected funds for David Allen Company's work and retained those funds for its own purposes, including holding 10 percent retainer while GSA was withholding no retainer on the prime contractor.

The prime contractor acknowledges an outstanding balance of $151,446 including $9,421 interest. For a number of months we appealed in vain to GSA and the contracting officers as well as to the prime contractor. Our efforts to collect these funds, now more than ten months past due, has cost approximately $8,000 in legal fees with no funds yet received.

Conley C. Cribb
David Allen Company
Raleigh, North Carolina

Ohio

Pedersen Insulation pays all bills for materials and services within 30 days. Labor is paid weekly. When general contractors and mechanical (prime) contractors hold up payment for 60-120 days, you can imagine the cash flow required. This is an unfair practice if the prime contractor is receiving payment in 30-45 days. The added subcontractor costs are passed on to the owner.

Deborah L. Knox
Pedersen Insulation Company
Columbus, Ohio 43230

As a small subcontractor, we have experienced slow pay from general contractors on a steady basis, particularly with regard to any Federal or State projects, to the point where it is not profitable to even bid this type of work.

David C. Frech
The Edward R. Hart Company
Canton, Ohio

Pennsylvania

Timely cash flows are critical to the survival of most subcontractors. Because we are an established and successful subcontractor, we can borrow from our bank to pay our payrolls and our suppliers when our customers delay our payments, . which many do on a regular basis. Last year our average daily loan balance from our bank was approximately $750,000 (over 10 percent of our annual sales volume) because most of our customers take more than 45 days to pay us, in spite of our contract terms. Smallers subcontractors might not survive under thse conditions. Many of our customers routinely hold our payments 15 to 30 days to earn interest or pay someone else. The former controller of one of our customers even bragged how he earned enough interest each year, by delaying payments to subcontractors, to cover his annual salary. Some general contractors look at this practice as a major source of income in addition to the actual construction process.

John F. Savoy
Baeger Acoustical Company, Inc.
West Chester, Pennsylvania

Rhode Island

The following inormation illustrates the slow pay we are experiencing from prime contractors on federal projects. As one can see, the balances are quite large and long overdue. We must have a "prompt pay for subcontractors" bill to prevent these long overdue accounts.

Department of Defense

Date	Invoice Payment	Current	Over 30 Days	Over 60 Days	Over 90 Days
11/15	$ 3,900	$ 3,900	---	---	---
12/16	42,520	42,520	$ 3,900	---	---
1/16	3,510	---	42,520	$ 390	---
2/04	64,120	64,120	42,520	390	---
3/05	35,000	---	---	---	---
	49,020	49,020	64,120	7,910	---
2/28	35,000	49,020	37,030	---	---
3/31	7,590	56,610	37,030	---	---
4/30	21,000	---	56,610	16,030	---
5/01	17,660	17,660	56,610	16,030	---
6/03	18,300	18,300	17,660	7,590	$65,050
6/16	6,831	18,300	17,660	7,590	58,219
6/30	15,894	---	---	---	---
	8,850	27,150	---	17,660	49,915
8/05	14,290	14,290	8,850	18,300	67,575
8/12	60,000	14,290	8,850	18,300	7,575
9/10	26,450	26,450	14,290	8,850	25,875
9/30	8,300	34,750	14,290	---	34,725
10/15	15,000	8,300	26,450	14,290	19,725
12/29	15,000	---	---	---	53,765

Environmental Protection Agency

Date	Invoice Payment	Current	Over 30 Days	Over 60 Days	Over 90 Days
1/15	$ 846	---	---	---	---
5/23	7,250	$ 7,250	---	---	$ 846
9/29	3,200	3,200	---	---	8,096
10/24	10,630	13,830	---	---	8,096
11/24	21,180	21,180	$13,830	---	8,096
12/06	6,525	21,180	10,630	$ 3,200	1,571
12/22	31,410	52,590	---	13,830	1,571
1/12	6,000	31,410	21,180	9,401	---
1/23	11,750	11,750	31,410	21,180	9,401

Vincent J. Zarrella
Zarrella Plumbing & Heating Co., Inc.
Cranston, Rhode Island

South Carolina

In March 1986, my firm contracted with a North Carolina general contractor for additions and alterations to the Aircraft Ground Equipment Shop at Myrtle Beach Air Force Base. The following is a cash flow statement on this project.

Date	Invoice/ Payment	Current	Over 30 Days	Over 60 Days	Over 90 Days
7/25	$ 2,866	$ 2,866	---	---	---
8/25	32,937	32,937	$ 2,866	---	---
8/28	2,866	32,937	---	---	---
10/7	10,000	---	22,937	---	---
11/10	10,000	---	---	$12,937	---
12/9	2,000	---	---	---	$10,937

You will note that, as of March 1, 1987, we were still owed $10,937. It is my understanding that the prime contractor was paid on this project.

Sonny McDowell
Grayco Steel Corporation
Myrtle Beach, South Carolina

Tennessee

While my business is supplying materials to subcontractors, passage of S.328 would have a positive effect on my receiving payment. Similarly, the present system of payment has resulted in slow payment to me. As a specific instance, C.A. Griffis Roofing Company, Inc. of Nashville used materials furnished by me on a Department of Army job last year. The general contractor deferred payment for months . . . before paying Griffis or Griffis paying me. Non-payment on this job was a contributing factor in a decision by Griffis to discontinue his business.

Carl Hudson
Hudson & Associates
Nashville, Tennessee

Not unlike the prime contractors, subcontractors also incur expenses. Therefore, prompt payment from the prime contractor would be an asset in maintaining a steady flow of operations.

Clay Zorn
Kidd Steel
Nashville, Tennesese

Texas

In September of 1985, our firm installed approximately seven hundred feet of quarry tile at the main entrance of the Veteran's Administration Medical Center in Amarillo, Texas. Our portion of this work was completed and accepted by the job superintendent in mid-September 1985.

Our company submitted the statement for the work on September 17, 1985. We contacted the general contractor several times between September 1985 and the end of January 1986 which was in excess of 125 days. On each occasion we were told by the general contractor that he "had not yet received his payment for the job."

On approximately February 1, 1986, we learned that the general contractor had in fact received payment. Subsequently, we contacted the general contractor several more times and threatened to contact the bonding company for payment of the statement which was long past due.

In early February, after several such calls, we received full payment for work completed and accepted by the general contractor's representative in mid-September -- in excess of 150 days earlier.

Tom Yeoman
Holland Tile & Marble Company, Inc.
Amarillo, Texas

Virginia

On one job for the Department of Defense, the prime contractor delayed payment of $12,000 to me for quite a lengthy period. When I checked with the contracting officer, I was told the prime contractor had already been paid. I finally received payment from the prime contractor 69 days later.

M.R. Sullivan, Jr.
Sullivan Mechanical Contractors, Inc.
Shenandoah, Virginia

Washington

Not being paid for extended periods of time works a great hardship on a subcontractor. Many times the prime contractors invest money on short term when it should be paid to his subcontractor.

Morris B. Mehrer
Mehrer Drywall, Inc.
Seattle, Washington

The Case for Section 7 of the Prompt Payment Act Amendments of 1987

**AMERICAN SUBCONTRACTORS
ASSOCIATION, INC.**

THE CASE FOR
SECTION 7
OF THE
PROMPT PAYMENT ACT AMENDMENTS OF 1987

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INTRODUCTION

Section 7 (Payment Clause for Subcontracts under Construction Contracts) of S.328/H.R.1663 requires a prime contractor on a federal construction project to include a payment clause, an essential element of a complete contract, in the agreements which it negotiates with its various subcontractors. Section 7 recognizes the "prevailing industry standard" as the payment term to be reflected in the subcontract payment clause. The "prevailing industry standard" currently is deemed to be seven days after the prime contractor is paid by the government, based on a joint policy statement adopted by the Associated General Contractors of America (AGC), the American Subcontractors Association (ASA), and the Associated Specialty Contractors (ASC) (See page 12). To provide the essential enforcement mechanism, the Section goes on to require that the agreement between a prime contractor and a subcontractor must entitle the subcontractor to a late payment interest penalty at the same rate applicable between the prime contractor and the government, if the prime contractor fails to make payment in accordance with its subcontract's payment clause. Other than these prescribed minimum standards, the parties to the subcontract are completely unfettered to negotiate the other terms of their payment clause.

Section 7 was drafted specifically to recognize and preserve the principle of privity of contract between a prime contractor and its subcontractors. The Section seeks to accord the protections of the Prompt Payment Act of 1982 to construction subcontractors within the "four corners" of their subcontract agreements.

Such a requirement is particularly needed on federal construction, which lends itself to a significant amount of subcontracting. On the average, less than 20 percent of a typical federal construction project is accomplished by the general contractor's own work force, leaving approximately 80 percent to be performed by subcontractors.

Subcontractors depend on the cash flow generated by payments on account to meet their payrolls and loan payments and to pay their suppliers. Yet testimony presented to the Senate Committee on Small Business, the Senate Committee on Governmental Affairs, and the House Committee on Government Operations indicates that some prime contractors on federal construction take 60, 90 or more days after they are paid by the government to pay their subcontractors and suppliers.

Thirty-four groups, including ASA, ASC, the Associated Builders and Contractors, the National Association of Minority Contractors, and the National Federation of Independent Business, have announced their support for Section 7, as a reasonable solution to a pervasive problem. AGC is the only national association to announce its opposition to "prompt pay for subcontractors" legislation.

AGC has emphasized that Section 7 is not worthy of even consideration by the United States Congress because the problem of late payment to subcontractors is an illusory one. AGC maintains that the only reason that subcontractors experience late payments is because the government has failed to make timely payments to the prime contractor.

Summary: The Impact of Slow Pay to Subcontractors on Federal Construction

Is slow pay to subcontractors a problem on federal construction? How widespread is slow pay? Does it harm those subcontractors who experience it? Is the federal government adversely impacted when its prime contractors practice slow pay?

In an effort to obtain detailed information on the impact of slow pay to subcontractors on federal construction, ASA conducted two nationwide surveys of subcontractors in March 1987.

The first survey was sent by ASA to 1000 subcontractors randomly selected from its membership list. The survey questionnaire was mailed by the ASA National Office on March 27, 1987, and the completed forms were received by the ASA National Office between April 3 and April 17, 1987. Completed questionnaires were returned by 322 of the 1,000 members to which the survey was distributed, representing a 32.2 percent response rate.

In order to confirm the results of the survey of ASA members, ASA sent an identical survey to 1000 subcontractors randomly selected from the membership list of the Associated General Contractors of America. The only additional qualifier was that they *not* also be ASA members. Completed questionnaires were returned by 141 of the 1,000 AGC members to which the survey was distributed, representing a 14.1 response rate.

The survey responses provide definitive answers to the above questions and allow one to draw the following conclusions with regard to slow pay to subcontractors on federal construction:

- The majority of ASA members surveyed (62.7%) perform work on federal construction, which typically represents 10% to 15% of their annual volume.
- Smaller companies are more likely to serve as subcontractors on federal construction than larger companies. More than 70% of subcontractors with annual volume of less than $2 million perform federal construction, while only 28.6% of those with annual sales volume over $25 million perform federal construction.
- The average subcontractor that performs federal construction has performed ten federal construction projects since the implementation of the Prompt Payment Act in October 1982.
- Subcontractors wait an average of 60 days after submitting a request for a progress payment before receiving payment on federal construction.
- Prime contractors on federal construction retain an average of 10% of the progress payments otherwise due to their subcontractors.
- Subcontractors wait an average of 120 days after they last perform labor or supply material to a federal construction job before receiving final payment.
- Subcontractors use a variety of techniques to collect late pay on federal construction. The two most frequently used are: (1) directly pursuing payment from the general contractor (93.5%), and (2) requesting assistance from the Government's contracting officer (62.1%). More than 16% stopped work until payment was received.
- More than 40% of subcontractors have delayed work on federal construction until payment was received; more than 10% have substituted materials in order to compensate for lost profit due to late payments on federal construction.
- More than 60% of the subcontractors who perform federal construction increase their bids in anticipation of late payment by general contractors.
- Only 2.9% of the subcontractors who have been paid late on federal construction have received interest for late payments **under the terms of their subcontracts.**
- More than 60% of the subcontractors who have performed work on federal construction have lost money because of late payments by general contractors.

The results of this survey must be viewed in the context of payment standards existing on both commercial and government construction. Under the terms of the AGC/ASA/ASC Joint Policy Statement on Prompt Pay, the subcontractor should be paid by the prime contractor within 24 days of the submission of a progress payment requisition to the prime contractor. Senior managers within the federal agencies with substantial construction programs indicate that payments are made to prime contractors within 10-25 days after submission of the prime contractor's progress payment requisition to the agency. This should result in payments being received by subcontractors on federal construction within a range of 24-39 days. The ASA survey results make clear that this is not the case.

The ASA survey also clearly demonstrates that many problems are created for the federal government, as well as subcontractors, when prime contractors on federal construction delay payment to their subcontractors and suppliers. When subcontractors believe they will be paid late, they submit higher bids to the prime contractor, which are ultimately paid by the government and the taxpayer. On projects already under contract, when the subcontractors can no longer adjust their prices, nor expect to receive late payment interest penalties, the cost to the government takes the form of delay or reduced quality. To the subcontractor, delayed payments means lost profits or just losses, through no fault of their performance, only their inability to effectively enforce a right to timely payments due them.

ASA Survey of the Impact of Slow Pay to Subcontractors on Federal Construction

Question #1:
Do you perform work on federal construction projects?

ASA Members	**AGC Members**
Yes: 62.7%	Yes: 53.2%
No: 37.3%	No: 46.8%

Question #2:
What is your approximate annual sales volume?

ASA Members

Annual Volume	Total Respondents	Respondents Who Perform Federal Construction	Respondents Who Do **Not** Perform Federal Construction
Less than $500,000	13.2%	73.8%	26.2%
$500,000-$2 million	36.8%	71.4%	28.6%
$2 million-$5 million	27.3%	55.3%	44.7%
$5 million-$10 million	12.3%	56.8%	43.2%
$10 million-$25 million	8.2%	48.0%	52.0%
Over $25 million	2.2%	28.6%	71.4%

AGC Members

Annual Volume	Total Respondents	Respondents Who Perform Federal Construction	Respondents Who Do **Not** Perform Federal Construction
Less than $500,000	13.5%	73.7%	26.3%
$500,000-$2 million	36.2%	54.9%	45.1%
$2 million-$5 million	31.2%	45.5%	54.5%
$5 million-$10 million	12.8%	55.5%	44.5%
$10 million-$25 million	4.2%	50.0%	50.0%
Over $25 million	2.1%	66.7%	33.3%

Question #3:
What percentage of your annual sales volume is on federal construction?

ASA Members		**AGC Members**	
Range:	00.01%-90%	Range:	1.0%-95%
Mean:	18.8%	Mean:	25.5%
Median:	15%	Median:	15%
Mode:	10%	Mode:	10%

The remaining questions were asked with respect to work performed after October 1, 1982 only.

Question #4:
How many federal projects have you performed as a subcontractor?

ASA Members		**AGC Members**	
Range:	1-498 projects	Range:	2-150 projects
Mean:	59 projects	Mean:	24 projects
Median:	10 projects	Median:	12 projects
Mode:	10 projects	Mode:	4 projects

Question #5:
On the average, how many days after submitting a pay request were you paid?

ASA Members		**AGC Members**	
Range:	20-135 days	Range:	20-120 days
Mean:	58.6 days	Mean:	55.6 days
Median:	60 days	Median:	55 days
Mode:	60 days	Mode:	60 days

Question #6:
What was the longest time you waited to be paid after submitting a pay request?

ASA Members		**AGC Members**	
Range:	30-1460 days	Range:	30-1140 days
Mean:	165.8 days	Mean:	163.6 days
Median:	90 days	Median:	115 days
Mode:	60 days	Mode:	120 days

Question #7:
On the average, how much retainage was withheld from you on these projects?

ASA Members		**AGC Members**	
Range:	0%-15%	Range:	0%-15%
Mean:	9.89%	Mean:	9.68%
Median:	10%	Median:	10%
Mode:	10%	Mode:	10%

Question #8:
On the average, how many days after you last performed labor or supplied material to the job, did you receive final payment including retainage?

ASA Members		**AGC Members**	
Range:	30-740 days	Range:	30-365 days
Mean:	168.38 days	Mean:	147.70 days
Median:	120 days	Median:	120 days
Mode:	90 days	Mode:	180 days

Question #9:
What was the longest you waited to receive final payment, including retainage, after you last performed labor or supplied material?

ASA Members		**AGC Members**	
Range:	40-1825 days	Range:	30-1460 days
Mean:	130 days	Mean:	280.5 days
Median:	180 days	Median:	180 days
Mode:	180 days	Mode:	180 days

Question #10:
When you were paid late on a federal construction project, what steps did you take?

ASA Members		**AGC Members**	
Nothing	11.8%	Nothing	13.8%
Contacted the prime contractor and asked to be paid	93.5%	Contacted the prime contractor and asked to be paid	92.3%
Contacted the government contracting officer and asked for assistance in getting paid	62.1%	Contacted the government contracting officer and asked for assistance in getting paid	60.0%
Collected interest under the terms of the subcontract	2.9%	Collected interest under the terms of the subcontract	4.6%
Applied for arbitration under the terms of the subcontract	4.7%	Applied for arbitration under the terms of the subcontract	1.5%
Filed suit in state court for enforcement of the terms of the subcontract	7.1%	Filed suit in state court for enforcement of the terms of the subcontract	4.2%
Stopped work until payment was received	16.6%	Stopped work until payment was received	26.1%
Stopped work and filed suit under the Miller Act	8.8%	Stopped work and filed suit under the Miller Act	15.3%

Question #11:
When preparing a bid for a federal construction project, have you increased your bid in anticipation of poor payment practices?

ASA Members	**AGC Members**
Yes: 61.7%	Yes: 71.2%
No: 38.3%	No: 28.8%

Question #12a:
When working on a federal construction project, have you delayed work until payment was received?

ASA Members	**AGC Members**
Yes: 43.6%	Yes: 64.6%
No: 56.4%	No: 35.4%

Question #12b:
When working on a federal construction project, have you substituted materials in order to compensate for profit lost due to late payments?

ASA Members	**AGC Members**
Yes: 10.3%	Yes: 12.5%
No: 89.7%	No: 87.5%

Question #13:
Have you lost money on a federal construction project because of delayed payments?

ASA Members	**AGC Members**
Yes: 60.6%	Yes: 64.6%
No: 39.4%	No: 35.4%
Range of Loss: $1,000-$400,000	Range of Losses: $3,000-$100,000

Individual Subcontractor Responses Detailing the Harmful Impact of Slow Pay on Federal Construction

Alaska

Lawrence M. Slay, Jr.
Acme Electric Company, Inc.
Fairbanks, Alaska

"We recently did work at Eielson Air Force Base. Our pay lagged 60 to 90 days from the time the general contractor was paid, and ours wasn't the only incidence of this abuse. We complained several times to the Corps of Engineers, but since we were subcontractors, they could do nothing."

Arizona

A.L. McCune
A.L. McCune Dry Wall Company, Inc.
Tucson, Arizona

"A good example of slow pay occurred on a recent job for the U.S. Air Force. I received one-half of my retention only after a significant delay. Whenever I checked, the general contractor told me he had not yet been paid. Yet the check stub that was accidentally included with my payment showed he had received full payment 37 days earlier."

Arkansas

Dan Billingsley
Tile Center, Inc.
Benton, Arkansas

"During the last year, I have worked on two projects for the U.S. Postal Service. On one project, I have been owed $22,000 for nearly nine months. On the second, I have been owed over $6,000 for four months. In both cases, the prime contractor has been paid."

Florida

Hugh Munnell
Brown Automatic Sprinklers, Inc.
Tampa, Florida

"As a subcontractor who has worked on numerous federal jobs, we have experienced the hardships caused by the lack of our cash flow brought on by the prime contractor, who while having received payment for our work, has not paid us. Routinely, prime contractors collect for a subcontractor's work he certifies to the government as complete, but withholds the monies due the subcontractor claiming his lack of performance. In addition to the hardship caused the subcontractor, the prime contractor is unjustly enriched from the use of the subcontractor's money. Often the prime contractor will drag out such payments to the subcontractor for as long as three to six months."

Georgia

Jack M. Cherry
Columbus Automatic Door, Inc.
Columbus, Georgia

"In January 1985, our firm contracted with a subcontractor for work to be performed at the Maxwell Air Force Base Area Exchange in Alabama. In other words, we were a sub-subcontractor on the job. In September 1986, not having received payment for our last three invoices ($5892.85) or our retainage ($1666.15), I wrote to the Army & Air Force Exchange Service requesting information on the project, including whether the general contractor had been paid. The only response was a letter with a routine recitation of my rights under the Miller Act. Nonetheless, it is my understanding, that the general contractor on this project was, indeed, paid. But the subcontractor, and thus our company, has not been paid."

Louisiana Russell Stratton
Stratton, Inc.
Lake Charles, Louisiana

"In one Department of Defense job in our area, the prime contractor left over $1,000,000 in retainage on the job. Because of front-end loading, the prime had collected all his money from the job by that time; the remaining $1,000,000 was for work performed by the various subcontractors. Obviously, these subcontractors were never paid."

Maryland Allan L. Baggott
Controls Systems Sales, Inc.
Laurel, Maryland

"As a subcontractor (many times a sub-subcontractor) on government projects, we have experienced payment delays even though the general contractor has been paid. Prompt payment assures a good working relationship between all parties. The owner and all parties involved may suffer time delays, increased overhead and poor workmanship if this relationship breaks down. Competition may also be limited due to subcontractors' reluctance to bid these jobs because of payment."

Maine Chris Wetherall
Industrial Vacuum Company
Portland, Maine

"Our company frequently does military contracting work. We, however, have had to adopt a policy of no subcontracting except to companies in-state with whom we already do non-military work. This is because we have been taken so many times by so many military prime contractors. We have no protection, as a practical matter, under the law. The federal government's payment policies permit the large prime contractor to abuse his subs if he so desires. We should not allow the fox to care for the chickens."

Michigan Norman VanWormer
Bay Line Fire Protection, Inc.
Pinconning, Michigan

"We are a small firm so when prime contractors do not pay us, we cannot pay our suppliers which creates a big problem when we need credit, bonding, etc. Our company personally has had trouble collecting money on time and I am sure all subcontractors have had the same problem."

Mississippi R. Norman Bailey
Trinity Materials, Inc.
Hattiesburg, Mississippi

"One contractor still owes Trinity Materials, Inc. for materials supplied on a job at Kessler Air Force Base over eight months ago. Another company has already been paid by the government for completion of his contract, but is more than a month behind in paying for material we provided to him."

New Mexico

Rusty Arrighetti
The Mayhew Company
Albuquerque, New Mexico

"We were a sub-subcontractor on a Department of Energy job. I had done business with the subcontractor with whom I contracted before and had always been paid promptly. But the general contractor on the job was from out-of-state. Pay was at least 30 days late from the very beginning of the job because the subcontractor was not being paid by the general contractor. For example, we invoiced in August for payment in September, but would not receive payment until October. We were told, 'You just have to get along; this is the way it's going to be.' Both the subcontractor and I contacted the general contractor but did not get acceptable answers. The contracting officer refused to talk to us because we did not have 'privity of contract'. We completed our work on the job in February 1986 and submitted our request for retainage ($5,000). The building was occupied in April 1986. I was finally paid my retainage in June 1986."

New York

Floyd Warkol
Warkol Mechanical Corporation
Bronx, New York

"Many prime contractors use the argument that payments to subs are sometimes delayed because of poor performance. However, if full payment has not been earned by a subcontractor because of poor performance, the prime contractor should not certify the completion of such work in his billing to the government. Thus, the government, not the prime contractor, should be holding all unearned payments until they have been earned."

North Carolina

Conley C. Cribb
David Allen Company
Raleigh, North Carolina

"David Allen Company entered into a $554,970 contract with a prime contractor for installation of our product in constructing a federal building project composed of three buildings in downtown Savannah, Georgia, owned by the General Services Administration. For a number of months, every pay request was reduced while the prime contractor's project manager was concurrently submitting larger pay requests to GSA and falsely certifying that David Allen was being paid per the prime contractor's own payments from GSA. No payment was made on the final two monthly billings. That is, the prime contractor collected funds for David Allen Company's work and retained those funds for its own purposes, including holding 10 percent retainer while GSA was withholding no retainer on the prime contractor. The prime contractor acknowledges an outstanding balance of $151,446 including $9,421 interest. For a number of months we appealed in vain to GSA and the contracting officers as well as to the prime contractor. Our efforts to collect these funds, now more than ten months past due, has cost approximately $8,000 in legal fees with no funds yet received."

Ohio

Deborah L. Knox
Pedersen Insulation Company
Columbus, Ohio

"Pedersen Insulation pays all bills for materials and services within 30 days. Labor is paid weekly. When general contractors and mechanical (prime) contractors hold up payment for 60–120 days, you can imagine the cash flow required. This is an unfair practice if the prime contractor is receiving payment in 30–45 days. The added subcontractor costs are passed on to the owner."

Pennsylvania

John F. Savoy
Baeger Acoustical Company, Inc.
West Chester, Pennsylvania

"Last year our average daily loan balance from our bank was approximately $750,000 (over 10 percent of our annual sales volume) because most of our customers take more than 45 days to pay us, in spite of our contract terms. Many of our customers routinely hold our payments 15 to 30 days to earn interest or pay someone else. The former controller of one of our customers even bragged how he earned enough interest each year, by delaying payments to subcontractors, to cover his annual salary."

South Carolina

Sonny McDowell
Grayco Steel Corporation
Myrtle Beach, South Carolina

"In March 1986, my firm contracted with a North Carolina general contractor for additions and alterations to the Aircraft Ground Equipment Shop at Myrtle Beach Air Force Base. Throughout the project, the payment was slow. As of March 1, 1987, we were still owed $10,937. It is my understanding that the prime contractor was paid on this project."

Tennessee

Carl Hudson
Hudson & Associates
Nashville, Tennessee

"C.A. Griffis Roofing Company, Inc. of Nashville used materials furnished by me on a Department of Army job last year. The general contractor deferred payment for months . . . before paying Griffis or Griffis paying me. Non-payment on this job was a contributing factor in a decision by Griffis to discontinue his business."

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Holland Tile & Marble Company, Inc.
Amarillo, Texas

"In September of 1985, our firm installed approximately seven hundred feet of quarry tile at the main entrance of the Veteran's Administration Medical Center in Amarillo, Texas. Our portion of this work was completed and accepted by the job superintendent in mid-September 1985. Our company submitted the statement for the work on September 17, 1985. We contacted the general contractor several times between September 1985 and the end of January 1986 which was in excess of 125 days. On each occasion we were told by the general contractor that he 'had not yet received his payment for the job.' On approximately February 1, 1986, we learned that the general contractor had in fact received payment. Subsequently, we contacted the general contractor several more times and threatened to contact the bonding company for payment of the statement which was long past due. In early February, after several such calls, we received full payment for work completed and accepted by the general contractor's representative in mid-September—in excess of 150 days earlier."

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Washington

Morris B. Mehrer
Mehrer Drywall, Inc.
Seattle, Washington

"Not being paid for extended periods of time works a great hardship on a subcontractor. Many times the prime contractors invest money on short term when it should be paid to his subcontractor."

Wyoming

Emeric Solymossy
A&E Electric, Inc.
Casper, Wyoming

"I have performed work on federal projects (V.A. Hospital, Sheridan, WY; Evanston Waste Water Treatment Plant, Sheridan, WY; Bureau of Reclamation, Alcova Power Plant, WY) where I have had to beg, plead, threaten and even file claims due to nonpayment by the general contractors, when they frequently have received their payment. It is unfortunately a common occurrence for a contractor to tell our office that they have not received payment, when the contracting officer has in fact confirmed payment."

Joint Policy Statement 1: Prompt Payment

Undue delays by owners, architects/engineers, general contractors, subcontractors and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of the Associated General Contractors of America, the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of AGC, ASA and ASC are urged to make efforts, singly or cooperatively where possible, to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month	**Event**
20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

April 7, 1987

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
ATTN: Chief Clerk
United States Senate
Washington, D.C. 20510-6250

Dear Mr. Chairman:

On behalf of the American Subcontractors Association, I want to thank you once again for the opportunity you provided to air the concerns of the construction industry on payment to subcontractors before your Committee on March 19. We believe the Committee provided a forum for the open and free exchange of opinions by various representatives of the construction industry.

We believe this exchange has been further facilitated by the questions submitted to us by Senator Sasser by letter dated March 25, 1987. Our responses to these questions are attached.

The issue of "prompt pay for subcontractors" has been my first foray into the federal legislative arena. I have been gratified at the support and assistance I have received not only from my own Senator, Paul Trible, but the other members of the Committee, as well as their staffs.

As a result of my efforts on this issue on behalf of ASA, I have had the privilege of talking to literally hundreds of subcontractors from around the country and corresponding with many more. I have tried to communicate these subcontractors' collective experience to you and the Committee in as accurate a fashion as possible.

You can be assured that if there is any other information that I or ASA can provide to help your Committee resolve this issue, we will do so to the best of our ability.

Sincerely,

Mac Sullivan

M.R. Sullivan, Jr.
Chairman
Government Relations Committee

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
1004 DUKE STREET, ALEXANDRIA, VA 22314-3512
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M.R. Sullivan, Jr.
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1. A fundamental thrust of AGC's opposition to Section 7 is founded upon the assertion that it places new risks and liabilities on the prime contractor while denying the "traditional private subcontract administration tools." Mr. Emerick, the witness for the Associated General Contractors of America (AGC), repeatedly emphasized that without subcontractor bonding the prime contractor must retain "all of the requisite and traditional procedures . . . necessarily including terms of payment" to protect itself.

a. What is your understanding of these "requisite and traditional procedures"?

Answer:

A prime contractor has many tools to assure assure subcontractor performance.

First, the prime contractor has the terms of the subcontract itself, the enforcement of which he can pursue through negotiation, mediation, arbitration, or litigation. Typical subcontracts include warranty provisions, procedures for claims, notice provisions, and other "performance cure" tools, including termination provisions.

Second, the prime contractor has responsibility and the right to regularly inspect the subcontractor's work. Since assuring subcontractor performance is one of the major functions of the prime contractor, he, in fact, has the obligation to thoroughly inspect the subcontractor's work and then carefully review the subcontractor's payment requests to assure that payment is made only for work which is completed, in place, and meets specifications.

Third, the prime contractor has the ability to withhold retainage from the subcontractor. Retainage is the practice of holding back a stated percentage, often as much as ten percent, from each progress payment to be paid upon completion of either the subcontractor's work or completion of the entire project. For example, as the subcontractor completes 100 percent of each segment of the contract, he receives only 90 percent of the agreed price for such completion.

Fourth, the prime contractor can require the subcontractor to post a payment and performance bond. The performance bond states that the subcontractor will build whatever it is he has contracted to build in accordance with the contract plans and specifications. The payment bond states that those people supplying labor and materials on a project will be paid subject to any restrictions and limitations imposed by statute or the subcontract.

Finally, the prime contractor can both withhold retainage and require a payment and performance bond. This provides double protection for the contractor.

M.R. Sullivan, Jr.
American Subcontractors Association

1.b. What traditional subcontract administration tools are lost under Section 7?

Answer:

The prime contractor loses no contract administration tools under the provisions of Section 7. Other than the minimal payment standard set forth, he is free to negotiate fully the remaining terms of the subcontract.

In addition: (1) He still can require the subcontractor to live up to the terms of the subcontract; (2) He still has the right to inspect the subcontractor's performance and to review and certify all payment requests; (3) He still can withhold retainage; (4) He still can require a payment and performance bond; and (5) He can still demand the double protection of both retainage and a performance and payment bond.

The only change is that, under the terms of Section 7, the prime contractor must make any adjustments, if any, in the subcontractor's pay request before he submits his own payment request to the government. If the prime contractor has any doubts about the subcontractor's full and proper performance or believes it is otherwise necessary, he may request less than 100 percent of the subcontractor's pay request from the government. However, once the prime contractor requests and then receives payment for work performed by the subcontractor, he cannot hold any monies he has been determined to be due to the subcontractor for more than seven days without paying a late payment interest penalty.

Thus, under Section 7, the government--not the prime contractor--would be holding any funds claimed by a subcontractor that a prime contractor disputes are due until that disagreement is resolved.

This is the heart of Section 7! It is designed to take the profit incentive out of a prime contractor's delaying payment to his subcontractors. Without that profit incentive, the prime contractor will not only pay faster but be willing to resolve disputes faster.

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1.c. Is a prospective subcontractor generally aware of the terms of payment, and any other terms that deviate from industry standard forms, e.g., AGC Form 600 (Subcontract for Building Construction), prior to submitting its bid or only after submission?

Answer:

Under normal circumstances, a subcontractor submits bids for a portion of a federal construction project to several general contractors prior to the time the general contractor must submit his bid to the government. It is rare that a subcontractor will know with certainty what the payment terms--or, indeed, the other substantive terms of the subcontract other than the specifications of the job--will be at the time he prices the job. The only access he may have to such information is through his own prior experience with a particular general contractor or through discussions with other subcontractors who may have worked for that general contractor.

Otherwise, the subcontractor may have no idea of the payment terms of the subcontract until he receives the unexecuted document--usually three to eight weeks after the award of the prime contract. At this time, the subcontractor often is placed in a "take it or leave it" position with respect to the terms of the subcontract.

As the Fifth Court of Appeals noted with respect to the bargaining position of the general contractor after the award of the prime contract:

> ". . . the number of subcontractors from which the prime contractor may choose is limited only by the scope of the industry, while would be subcontractors must seek the nod of a single prime contractor, who is in that respect a complete monopsonist."

Electronic and Missile Facilities, Inc. v. United States, Ex. Rel. H.W. Moseley, 306 F.2d 554 (C.A.5 1962).

Section 7 would establish a minimum standard for the subcontract payment term (based upon the "prevailing industry standard" of seven days, agreed to by AGC/ASA/ASC in their Joint Policy Statement on Prompt Payment), enabling the subcontractor to offer its lowest price without having to factor in additional sums to cover the contingency of unexpected extended payment terms or late payments by the prime contractor (since Section 7 would clearly entitle the subcontractor to late payment interest penalties).

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2. You stated that prime contractors currently have four ways to assure subcontractor performance: (1) careful and thorough inspection; (2) retainage; (3) bonding; and (4) retainage and bonding. You went on to say, if Section 7 were enacted, prime contractors would still have all four ways of assuring subcontractor performance. Section 7 merely requires a prime contractor to identify the reasons for, and the amounts of any appropriate reductions in the subcontractor's progress payment request, before submitting a requisition to the Government. Section 7 would only constrain a prime contractor from collecting from the Government, and then failing to disburse within seven days sums which he determined were due to the subcontractor, without incurring a late payment interest penalty. The Section-by-Section analysis of Section 7 seeks to reflect this interpretation. Mr. Emerick indicated that he does not agree with this interpretation of Section 7.

Q. Could you suggest how Section 7, or the Section-by-Section analysis, might be modified or amplified to make clear the broad subcontractor administration authorities retained by the prime contractor, prior to making application to the Government for a progress payment?

Answer:

After reviewing Section 7 of S.328 and the related section-by-section analysis, we believe the intent is clearly stated as follows:

> "As with the Act's application between the prime contractor and the Government, the subcontractor's entitlement to timely payment, or interest penalties for late payment, only applies when no dispute exists as to performance. The subcontractor is not entitled to payment if his or her performance is not in conformity with the project schedule or the Government's specifications (which the prime contractor is required by its contract with the Government to include in its subcontracts). Similarly, the prime contractor may be entitled by its subcontract to withhold a portion of a payment for: (1) work that is in dispute; (2) third party claims, filed or reasonably expected to be filed; (3) alleged damages suffered by the prime contractor or another subcontractor; or (4) overdue subcontractor payments for labor, equipment or materials. However, to assure equitable treatment of subcontractors, it is essential that a prime contractor identify subcontractor performance deficiencies and other claims in its

> application for payment, and any accompanying certificate, to the Government and not request payment for amounts in dispute with the subcontractor until such dispute is resolved."

However, if the Committee believes that clarification is necessary, ASA would suggest the addition of the following language to Section 7:

> Nothing in this section shall prevent a prime contractor, at the time of application for payment and certification to the cognizant Federal agency, from withholding:
>
> (i) payment to the subcontractor for any of the following reasons attributable to the subcontractor's performance:
>
> (1) unsatisfactory job progress;
> (2) defective work;
> (3) disputed work;
> (4) third party claims, filed or reasonably expected to be filed;
> (5) failure to make timely payments for labor, equipment or materials;
> (6) damages suffered by the prime or another subcontractor;
> (7) reasonable expectation that the subcontractor's work cannot be completed for the unpaid balance of the contract price as from time to time amended; or
>
> (ii) a reasonable amount of retainage, provided, however, that in no event shall the percentage of retainage withheld from the subcontractor exceed the percentage of retainage withheld by the Federal agency from the prime contractor.

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3. During his testimony, Mr. Emerick urged that if Section 7 is not deleted, it must be amended to require all subcontractors to post payment and performance bonds. The sponsors of Section 7, as well as its proponents, maintain that the provision leaves totally unimpaired a prime contractor's present discretion to require bonds from its subcontractors, when it makes good business sense.

a. Is a prime contractor always free to require performance and payment bonds from its subcontractors?

Answer:

There is nothing in Section 7 or in any existing law or regulation, nor does ASA believe there should be, to prevent a prime contractor from requiring a payment or performance bond of its subcontractors. Indeed, ASA believes it is the responsibility of the general contractor to evaluate the abilities of each of its prospective subcontractors and to make a business judgment as to whether to require the protection of payment and performance bonds, based on the complexity of the work to be performed and the qualifications of the individual subcontractors. Given that Section 7 does not diminish the prime contractor's capability to manage its subcontractors, the provision does not affect the judgmental equation which the prime contractor presently faces concerning the bonding of subcontractors.

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3.b. Are any problems likely to result from requiring subcontractor bonding across-the-board, rather than leaving it to the business judgment of the prime contractor to be exercised on a case-by-case basis.

Answer:

ASA believes a number of problems would arise from a mandatory subcontractor bonding requirement. Perhaps of most interest to this Committee would be the certainty of increased cost for federal construction.

First, of course, the price of the payment and performance bond would be passed on to the government.

Second, a mandatory bond requirement would reduce competition on federal construction. Many subcontractors, who might technically be capable of performing the work specified, may be unable to provide a bond because of "newness" or thin capitalization. Others, particularly smaller and closely-held family businesses, may be unable or unwilling to produce the the detailed financial information required by a surety company.

Besides additional cost, it should be noted that the surety industry has had three consecutive years of severe losses and no relief seems to be in sight. As a result, the capacity of the surety market is already strained. A mandatory subcontractor bonding requirement on federal construction would overload the system, leading, at a minimum, to tighter underwriting standards and higher bond premiums.

As noted above, ASA believes it is the responsibility of the general contractor to evaluate the abilities of each prospective subcontractor and to make its own business decisions regarding bonding of those subcontractors. Section 7 would not alter that situation nor alter the factors to be considered when the prime contractor makes such a business decision.

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4. In his testimony, Mr. Emerick presented an example to demonstrate why AGC believes Section 7 exposes prime contractors to unreasonable risks. In that example, a prime contractor's inspection fails to detect a deficiency in a subcontractor's work which is subsequently detected by the Government after the subcontractor has departed the job, having been paid (less any retained amounts) in conformity with Section 7. The Government looks to the prime contractor for corrective action and because the subcontractor was not bonded, Mr. Emerick asserted that the prime contractor is unreasonably exposed.

The AGC Form 600 requires a subcontractor "to warrant its work against all deficiencies and defects in materials and/or workmanship" for the period established in the contract between the owner and the prime contractor (a flow-down provision) or, if there is no such provision in the contract documents, "for the period of one year from the date(s) of substantial completion of all or a designated portion of the Subcontractor's Work, or acceptance or use . . . whichever is sooner."

a. Do such warranty provisions provide protection for the prime contractor in assuring subcontractor performance, both before and after the subcontractor has been paid?

Answer:

The AGC Form 600--as well as all other standard subcontracts developed by the industry--requires a subcontractor to warrant its work against deficiencies and defects. Such a warranty provision provides protection for both the owner and the prime contractor in the event problems are found with the subcontractor's work during the period of the warranty. The warranty provision can be enforced the same way as any other provision of the subcontract--through negotiation, mediation, arbitration, or litigation.

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4.b. How do such provisions operate in actual subcontract arrangements?

Answer:

If a prime contractor becomes aware of deficiencies or defects in a subcontractor's work, he notifies the subcontractor of the need for correction of such deficiencies or defects. Included in this notification should be a clear explanation of the problem, the location, and the time frame in which the prime contractor expects the corrective work to be completed. Subsequently, the general contractor (often in conjunction with the architect or other owner's representative) inspects the corrected work to assure that it has been completed in accordance with the original specifications.

The ability and willingness of the subcontractor to promptly comply with the warranty requirements are founded on the subcontractor's integrity, professionalism and financial resources--all of which can be scrutinized by the prime contractor prior to the award of the subcontract. ASA believes the prime contractor also has the obligation to help assure the fiscal soundness of its subcontractors by paying promptly for work that is performed, in place and meets specifications.

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5. In developing Section 7, the sponsors were under the firm impression that payment of a subcontractor by the prime contractor within seven days after receipt of the Government's payment by the prime actually reflected the prevailing industry standard and was, therefore, used as the bill's minimum standard for the subcontract payment term. The seven-day standard is reflected in the AGC-ASA-ASC Joint Policy Statement on Prompt Payment, as well as in the AGC Form 600 model subcontract agreement. The AIA's Standard Form of Agreement Between Contractor and Subcontractor (Document A-401) provides for a three-day payment term, which exceeds the Sector's prescribed minimum standard. No where within the Joint Policy Statement or the AGC Form 600 is there even an implication that the payment term applies only if the subcontractor is bonded. Yet, during his testimony, Mr. Emerick asserted that AGC endorses equal treatment regarding payment between the prime contractor and its subcontractor only when there is "like security", i.e., the same bonding protection that exists between the Government and the prime contractor.

a. Why wasn't this issue addressed, or even implied, in the AGC-ASA-ASC Joint Policy Statement?

Answer:

At no time during the negotiation among the parties to AGC/ASA/ASC Joint Policy Statement 1, Prompt Payment, did AGC raise the issue of "like security" as a requisite for prompt payment.

Since the AGC Board of Directors approved the Policy Statement (as did the boards of directors of ASA and ASC), ASA believes the policy statement represents an accurate statement of the position of AGC on payment at each tier of the construction process, rather than Mr. Emerick's characterization of that association's position during the committee's hearing.

I would be remiss if I did not point out that "like security" was raised by AGC in negotiations with ASA and ASC concerning retainage. Indeed, AGC incorporated this concern in its unilaterally developed Form 600 in Section 5.2.2, Retainage/Security, which states in part:

> "The rate of retainage shall not exceed the percentage retained from the Contractor's payment by the Owner for the Subcontractor's Work provided the Subcontractor furnishes a bond or other security to the satisfaction of the Contractor."

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American Subcontractors Association
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The ability of the prime contractor to demand "like security" from a subcontractor would not change under Section 7. Under the provision, a prime contractor may require a subcontractor to post a payment or performance bond.

In addition, a prime contractor may at any time before it receives funds from the Government for the subcontractor's work make a decision to withhold funds from the subcontractor because of what the prime contractor deems as deficient or defective performance on the part of the subcontractor. The only difference is that the Government--not the prime contractor--would be holding all funds until the subcontractor's performance meets specifications.

Again, a subcontractor should be paid promptly for work that is complete, is in place, and meets specifications. Until that time, the Government should retain control of those funds.

5.b. Do you agree with AGC's assertion?

Answer:

No. ASA believes that prompt payment is a right earned when work is complete, is in place, and meets specifications. Payment for work completed should not be tied to any basis for subcontractor prequalification used by the prime contractor; nor should payment be tied to the whim, fancy or mood of the prime contractor with no consideration given to actual performance.

6. Mr. Emerick also challenges the Section's "prevailing industry standards" payment term as both too vague and inflexible?

    a. Would you share with the Committee why you think it is a practical necessity to specify a definite payment term for inclusion in the agreement between a prime contractor and a subcontractor?

Answer:

There are two parts to every contract: the performance responsibilities and the counterperformance responsibilities (i.e., payment). No contract is complete without both. If a subcontractor is to perform as required by the specifications, he must know the timing and manner in which he will be paid for such performance.

6.b. Can you suggest a way to address the AGC's arguments concerning vagueness.

Answer:

Given AGC's concern about the vagueness of the term "prevailing industry standards", ASA would suggest that Section 7 of S.328 be amended as follows:

> (1) to pay the subcontractor within seven days of receipt of payment by the prime contractor from the agency for work performed by the subcontractor under that contract;

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7. In his testimony to the Committee, Mr. Emerick dismissed any imbalance in the bargaining power between parties to the subcontract agreement. He asserts that subcontractors are "free tp pick and choose their projects and the general contractors they work with." He also displayed to the Committee a copy of a publication entitled "Commentary on AGC Subcontract Document No. 600."

a. Would you respond to this assertion from the vantage point of the day-to-day business environment faced by subcontractors?

Answer:

The mere fact that there might be ten subcontractors from the same trade competing for one agreement on any given project puts a general contractor who has obtained a contract for that project in a superior bargaining position. Unlike the government who is required to award its contract to the lowest responsive and responsible bidder, the prime may award its subcontract to anyone it chooses. If a subcontractor is not awarded the job by the prime contractor with a contract to perform the project, there is no where else to turn. The subcontractor is placed in a "take it or leave it" position with respect to the terms of the subcontract, since the prime contractor is literally the "only game in town" with respect to that federal project.

As the Fifth Court of Appeals noted:

> " . . . the number of subcontractors from which the prime contractor may choose is limited only by the scope of the industry, while would be subcontractors must seek the nod of a single prime contractor, who is in that respect a complete monopsonist."

Electronic and Missile Facilities, Inc. v. United States, Ex. Rel. H.W. Mosely, 306 F.2d 554 (C.A. 5 1962).

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American Subcontractors Association

7.b. Would you comment on this publication and submit a copy for the record?

Answer:

From 1976 to 1984, ASA, in conjunction with the Associated Specialty Contractors, engaged in negotiations with the Associated General Contractors of America to develop a tripartite standard subcontract agreement. The negotiations were premised upon subcontract language that would provide the subcontractor the same rights, benefits, and obligations in relation to the contractor as the contractor has in relation to the owner under American Institute of Architects Document A201, General Conditions.

When negotiations ended unsuccessfully in 1984, AGC unilaterally developed and published its Document 600, Subcontract for Building Construction. The Form 600 denies the subcontractor many benefits and rights that the contractor has under the A201, as well as under Form 23A, the federal contract form, and other standard contracts. It imposes obligations on the subcontractor that, ASA believes, would elicit howls of anguish and protest from the AGC if AIA attempted to put them into the A201, or the government tried to insert them in Form 23A.

For example, Section 5.1.3, Payment Use Restriction, states that:

> "No payment received by the subcontractor shall be used to satisfy or secure any indebtedness other than one earned by the Subcontractor to a person furnishing labor or materials for use in performing the Subcontractor's Work."

ASA not only strongly supports the trust fund concept implied in this provision but, indeed, has submitted legislation to the Senate Small Business Committee which would embody this concept in federal construction.

However, the association objects when a similar limitation is not placed on the owner's payment to the prime contractor. But as AGC has testified, it is opposed to any government intrusion into the contract between the prime contractor and its subcontractors and and thus, it is opposed to extending the trust fund concept for payments made by the government to the prime contractor for work performed by a subcontractor.

ASA believes that many general contractors use model agreements, such as the Form 600, in good faith, not even being aware of the inequities and pitfalls for those they ask to sign the agreement. Suchcontractors willl usually accept equitable revisions from subcontractors with little argument.

Therefore, ASA and ASC developed the "Commentary on the AGC Subcontract Document No. 600" to educate subcontractors about the pitfalls of the Form 600 and how they can protect their interests if confronted with this unilaterally developed and biased document.

A copy of the "Commentary on the AGC Subcontract Document 600" is attached to these questions for inclusion in the record.

However, we note that it was not the "Commentary" that was displayed by the AGC witness, Mr. Emerick, but another ASA publication entitled "Winning the Battle of Subcontract Forms." Again, the publication, which is available for purchase by both ASA members and non-ASA members, was designed to educate subcontractors about very serious legal implications of many subcontract clauses that give general contractors unnecessary legal and practical advantages. A copy of "Winning the Battle of Subcontract Forms" is also attached to these questions for inclusion in the record.

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American Subcontractors Association

8. AGC strongly asserts that timely payment of subcontractors is its policy and the prevailing practice of its members and most other general contractors. It implies that prime contractors have little incentive to delay payments to their subcontractors as a routine practice. Proponents of Section 7 assert that there are very real incentives for prime contractors to make untimely payments to their subs. In your testimony to the Committee, you stated that late payments to subcontractors improves a prime contractor's "competitive edge" or "increase his profits."

Would you please elaborate on this statement?

Answer:

The holding by one party of funds belonging to another is a cash management tool that is abused by many--from the Office of Management and Budget in its interpretation of the Prompt Payment Act of 1982, to banks that hold checks for clearance for extended periods, to businesses who back-date checks to their suppliers. It calls to mind the old joke about the three biggest lies--one of them being "The check is in the mail." It is naive to think that general contractors in the construction industry are more honest or poorer cash flow managers than others.

In fact, prime contractors in the construction industry have every incentive, and few disincentives to delay payment to their subcontractors. The prime contractor can divert funds paid to him by an owner for work performed by a subcontractor into interest-bearing investments, project start-ups for other contracts, and even personal use. With the extra cash flow generated at the expense of its subcontractors, a prime contractor puts itself in a position to increase its bonding capacity and increase its line of credit.

Essentially, subcontractor funds diverted for the use of the prime contractor become an interest-free loan to that contractor. Most standard subcontracts provide few enforcement mechanisms for a subcontractor to collect funds--and the penalties for stopping work on the job are often severe.

Diverting funds from subcontractors is not the only tool used by prime contractors to improve their cash flow; it is not uncommon for prime contractors to divert the funds of the owner--a practice known as "front-end loading".

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"Front-end loading" is the practice of overvaluing the work of the early trades (*e.g.*, steel, roofing) at the expense of the later trades (*e.g.*, painting, flooring) on a project. As a result of "front-end loading", the prime contractor collects more money from the owner early in the job than has actually been earned either by himself or the subcontractors. The prime contractor may use this money to fund the start-up for the work to be performed by his own employees or, indeed, he may simply invest it for his own profit until he must pay the later finishing subcontractors.

Let me give you a simple example. The steel subcontractor contracts with the prime contractor to do a federal government project for $1,000,000. A painting contractor contracts with that same prime to do the painting on that same government job for $300,000. If the prime contractor chooses to front-end load the project (a common practice in the construction industry), he will bill the government $1,200,000 for the steel--$200,000 more than the work is worth--at the beginning of the job. Later, the prime contractor will bill the government $100,000 for the painting--$200,000 less than the work is worth--at the end of the job. Meanwhile, the prime contractor has had the use of an unearned $200,000 for many months, perhaps years.

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American Subcontractors Association

9. AGC argues that Section 7 is unnecessary because it duplicates protections against late payment afforded by various subcontract agreements, such as the AGC Form 600.

a. Does the AGC Form 600 agreement assure the subcontractor a late payment interest penalty at a rate equal to that applicable between the prime contractor and the Government under the Prompt Payment Act?

Answer:

Section 5.4, Late Interest Penalty, of the Form 600 states:

> "To the extent obtained by the Contractor under the Contract Documents, progress payments or final payment due and unpaid under this Agreement shall bear interest from the date payment is due at the rate provided in the Contract Documents, or, in the absence thereof, at the legal rate prevailing at the place of the Project."

Since the federal procurement agencies have interpreted the Prompt Payment Act of 1982 to not apply to construction progress payments, there is no rate of interest applicable between the prime contractor and the Government. Thus, any interest due a subcontractor under this provision would be calculated at "the legal rate prevailing at the place of the Project."

If Section 5 of S.328 were enacted, any interest due to the subcontractor because of late payment by the prime contractor would be calculated at a rate equal to that applicable between the prime contractor and the Government under the Prompt Payment Act.

9.b. Does the AGC Form 600 make the subcontractor's entitlement to any late payment interest penalty contingent upon the prime contractor being able to pass the cost of the interest penalty on to the Owner, i.e., the Government?

Answer:

As noted in the above excerpt from Section 5.2.2 of the Form 600, a subcontractor's entitlement to late payment interest is contingent upon the prime contractor's ability to obtain payment from the Government--even if the delayed payment was solely the fault of the prime contractor.

M.R. Sullivan, Jr.
American Subcontractors Association

10. AGC also argues that Section 7 unnecessarily duplicates legal remedies already available. Specifically, the Miller Act is cited as providing adequate protection to subcontractors faced with delayed payments from their prime contractor during the term of on-going subcontract performance.

    a. Please explain to the Committee how the Miller Act provides protection to subcontractors faced with progress payments being improperly delayed by its prime contractor.

Answer:

In lieu of granting lien rights on federal projects, Congress enacted the Miller Act which, in addition to requiring a prime contractor to post a performance bond to guarantee completion of the project, requires a payment bond. The purpose of the Miller Act payment bond is to protect final payment to persons supplying labor and material on government projects where lien rights are unavailable.

The Miller Act has not lived up to the expectations of Congress. It is too costly and time-consuming for the small subcontractor to pursue. Generally, a subcontractor or supplier will only file suit under the Miller Act, and seek to obtain payment from the surety company that issued the bond, if the prime contractor appears to be insolvent and in danger of default to the government.

Even if the subcontractor decides to file suit under the Miller Act, he can only do so after 90 days from the date on which he last performed work or supplied material. Thus, the subcontractor has no recourse under the Miller Act for periodic progress payments unless he stops work on the project--an action that, presumably, the government would want to discourage.

In any event, the resulting delay in payment for months or even years can easily bankrupt a subcontractor.

M.R. Sullivan, Jr.
American Subcontractors Association

10.b. Could the Miller Act be strengthened to become an effective remedy for delayed progress payments?

Answer:

As noted above, a subcontractor who does not receive a progress payment on a federal construction project is put in the untenable position of continuing to work without payment or pulling off a job and possibly halting all construction in order to begin the 90 day clock. One possible solution to this problem would be the extension of the Miller Act to cover progress payments which are more than 30 days overdue--similar to the provision in the "little Miller Act" in Massachusetts.

However, it should be noted that the Associated General Contractors of America historically has opposed legislation to so extend the Miller Act. The various associations representing the surety industry are also opposed to extending the Miller Act's coverage to late progress payments.

M.R. Sullivan, Jr.
American Subcontractors Association

11. In his testimony to the Committee, Mr. Buttrum stated that there is "no way a subcontractor can currently enforce the payment terms of his subcontract on the prime contractor in a timely fashion." He went on to say that "the only way to enforce payment on a Federal job is through a Miller Act law suit."

Answer:

Like the prime contractor, a subcontractor cannot enforce the terms of the subcontract through litigation.

However, the states and courts have long recognized that once equipment or material attaches to property, it cannot easily be removed. In order to protect the rights of a laborer, supplier, subcontractor or anyone else who furnishes labor and materials to a prime construction contractor to be paid for their services, the various states enacted lien laws to secure a certain priority of payment and thereby aid in the collection of sums due.

Since all federal property is, in effect, owned by the people, the courts have held that it is neither right nor proper for liens to attach to any federal projects. In lieu of granting lien rights on federal projects, Congress enacted the Miller Act. See response to Question 9 above.

M.R. Sullivan, Jr.
American Subcontractors Association

12. Each of the witnesses on your Panel Four shared with the Committee his views concerning the precedential value of current contract provisions mandated for flow-down between a prime contractor and its subcontractors on federal construction projects. The testimony of AGC's witness and the attachments to its written statement vigorously assert that there is no precedential value. The 18 February 1987 legal memorandum from King and King states: "The only areas in which the Federal Government has injected itself involving subcontractor matters involves socio-economic programs of the Federal Government." In a 13 March 1987 letter to the Chairman of the Committee on Small Business, Hubert Beatty, executive vice president of the Associated General Contractors of America, said: "Each and every flow-down pursues one or another of broad National social, labor, economic, environmental, or fiscal policies . . . ." During his oral testimony, Mr. Emerick stated on several occasions that the various mandated subcontract provisions address only "socio-economic, civil rights or environmental matters."

What is your evaluation of the existing flow-down provisions?

Answer:

Existing flow-down provisions clearly indicate that it is not uncommon for the federal government to legislatively or administratively impose its will upon the contracting practices between government prime contractors and their subcontractors. Indeed, this concept of government mandated subcontract provisions on federal projects underlay the entire effort of the American Bar Association in devising a model "FAR-Compatible Terms for Subcontracts under Federal Government Fixed Priced Construction Contracts".

The mandated subcontract clauses range from "socioeconomic" purposes to other government interest areas such as "patent law", "truth in negotiations" (regarding fraudulent claims and cost and pricing matters), "labor relations", "value engineering", and the one which has been conveniently ignored by opponents of Section 7, compliance with the actual "Specifications and Drawings of Construction."

There are two parts of every contract: the performance responsibilities and the counterperformance responsibilities (i.e., payment). The government has acknowledged in the above-referenced flow-down provisions that it has a very real interest in subcontractor performance. The fact is the government also has a very real and direct interest in assuring payment to its subcontractors.

When subcontractors believe they will be paid late, the prime contractor and thus the government will receive higher bids on its projects, in some cases substantially over estimate.

On projects already under contract where little can be done by the subcontractor to alleviate unanticipated expenses caused by late payments, the cost to the government may take the form of delay. A subcontractor who has lost most of his profit expectation in a job but who still has a lot of work to complete, poses another kind of problem to the government. A subcontractor cannot be expected to work for nothing and the government gets no "bargain" when a subcontractor is precluded from earning a reasonable profit.

Enactment of Section 7 would not only assure a subcontractor that he will receive equitable payment terms on federal construction but it provides an effective enforcement mechanism for those payment terms. This can only have a beneficial impact on the cost of government construction.

In addition, Section 7 would help prevent "front end loading" by requiring a prime contractor to pay its subcontractors the total amount of money collected for their work within seven days after being paid for that work by the government. The prime contractor certainly will not pay a subcontractor more than the value of its work. Therefore, the current built-in incentive for "front end loading" would be removed.

M.R. Sullivan, Jr.
American Subcontractors Association

13. A review of AGC Form 600 reveals several flow-down provisions with respect to a subcontractor paying its sub-subcontractors and suppliers. For example, Section 5.1.3 (Payment Use Restriction) states: "No payment received by the subcontractor shall be used to satisfy or secure any indebtedness other than one owned by the subcontractor to a person furnishing labor or materials for use in performing the Subcontractor's Work." While Section 5.1.4 states: "The Contractor shall have the right at all times to contact the subcontractor's subcontractors and suppliers to ensure that the same are being paid by the Subcontractor for labor or materials furnished for use in performing the Subcontractor's Work."

a. Don't these provisions seem to ignore the concept of "privity of contract", which AGC emphasizes in its arguments in opposition to Section 7?

Answer:

ASA agrees that these provisions, as well as several others in the Form 600, ignore the concept of "privity of contract".

M.R. Sullivan, Jr.
American Subcontractors Association

13.b. How do these provisions operate in practical business terms?

Answer:

The terms of Section 5.1.3 are often referred to as a "trust fund provision" in the construction industry. Conceptually, such provisions provide that funds received by one party for work performed by another party constitute trust funds--that is, they impose a fiduciary responsibility upon the recipients of construction funds. In the development of such provisions, care must be taken to assure that it does not impose an onerous accounting burden on the parties. In addition, the provision should apply to all tiers of the construction process.

Section 5.1.4 of the Form 600 would allow the prime contractor to contact a subcontractor's sub-subs or suppliers with respect to payment due for work performed or materials supplied under the subcontract. If not handled diplomatically, such contact could cause unnecessary anxiety about a subcontractor's credit worthiness.

M.R. Sullivan, Jr.
American Subcontractors Association

13.c. How would similar provisions work in the relationship between the Government and a prime contractor?

Answer:

A few states, such as New York and Wisconsin, have statutes that impose a fiduciary responsibility upon the recipients of construction funds. Under such legislation, funds are paid to a contractor or subcontractor with the implied understanding that they are to be maintained in trust until deserving parties are repaid. Only the leftover funds, or profit from the contract, may be diverted for use elsewhere. The criminal sanctions contained in these laws have made them virtually self-enforcing.

ASA is convinced that "trust fund" provisions have served well in several states to discourage diversion of funds, decrease owner vulnerability to liens and encourage the liberal extension of credit by subcontractors and suppliers. Such a provision benefits lenders, owners, construction firms and suppliers.

ASA believes that the trust fund concept lends itself naturally to adoption at the federal level. Adoption of the trust fund concept on federal construction would produce immense benefits for all concerned. It would protect prime contractors from failing or unscrupulous subcontractors who might otherwise be tempted to divert or misappropriate funds received by them to non-project purposes. It would protect subcontractors from primes who do the same. It would protect suppliers from misappropriation by either or both. It would protect sureties who stand behind the obligations of all. And, finally, it would protect American taxpayers by assuring that public funds would be used solely for the purposes for which they were authorized and obligated.

M.R. Sullivan, Jr.
American Subcontractors Association

14. In your statement you asserted that "the government has every right to be concerned that subcontractors are paid on time." AGC has repeatedly asserted that the government has no stake in this issue.

Would you please elaborate on the results that could reasonably be expected to flow if subcontractors are repeatedly exposed to delayed payments from prime contractors?

Answer:

Construction firms, particularly subcontractors, usually operate under very poor cash flow conditions. Subcontractors who expect but who do not receive timely payment often suffer very real hardship. Such hardship revolves around their inability to make current payments on materials, their inability to purchase additional materials for the job, and possibly their inability to pay their labor force. As a result, a subcontractor may be forced to slow-down or even stop his work until payment is received and his cash flow improves.

It is obvious that a subcontractor's cash flow can have a direct and real impact on the project schedule--and the owner's eventual ability to use the construction for its intended purpose at its intended time. Thus, every owner, including the Government, has a right to be concerned that all parties involved in the construction team from the architect to the general contractor to the subcontractors and materialmen are paid on time and with a minimum of delay.

Payment and the terms of payment are of primary importance in any contract in any industry. They are no less important in the construction industry.

STATEMENT OF THE ASSOCIATED SPECIALTY CONTRACTORS

ON

S. 328

AMENDMENTS TO THE PROMPT PAYMENT ACT (P.L. 97-177)

Presented By

DAVID A. BUTTRUM, VICE-PRESIDENT OF CONSTRUCTION
SWANSON-NUNN ELECTRIC COMPANY

to the

SENATE GOVERNMENTAL AFFAIRS COMMITTEE

March 19, 1987

Introduction

Mr. Chairman, Members of the Committee, my name is David Buttrum, I am and have been Vice President of Construction for Swanson-Nunn Electric Company for six years. Before that, I was Construction Manager and a Project Manager. Swanson-Nunn Electric Company is a family owned and operated business located in Evansville, Indiana. We specialize in heavy construction and heavy industrial work. I personally have been involved in, and managed Swanson-Nunn Electric Company's extensive construction effort as a subcontractor doing Corps of Engineer's work. Swanson-Nunn Electric Company was a subcontractor on two Lock and Dams on the Tenn-Tom Waterway and two Lock and Dams on the Red River. We have completed two Hydro-Electric plants designed by and constructed for the Corps of Engineers, along with a number of other projects in as many as six different Corps of Engineers Districts.

I am here today on behalf of the Associated Specialty Contractors, an umbrella organization representing the interests of eight major specialty construction trade associations, which - in turn - represent the interests of over 165,000 contracting firms. The eight groups making up the Associated Specialty Contractors include the Mechanical Contractors association of America (MCAA), The Mason Contractors Association (MCA), the National Roofing Contractors Association (NRCA), the National Electrical Contractors Association (NECA), The National Association of Plumbing, Heating and Cooling Contractors (NAPHCC), the National Insulation Contractors Association (NICA), the Sheet Metal and Air Conditioning Contractors National Association (SMACNA) and the Painting and Decorating Contractors Association (PDCA).

ASC member firms do a substantial percentage of the work on Federal building construction projects as sub-contractors and even sometimes as prime contractors. We were strong supporters of the original enactment of the Prompt Payment Act. However, a number of very serious problems affecting specialty contractors are not addressed in current law. Furthermore, the law as it exists now is not always being followed by the Executive branch agencies it is supposed to cover. ASC contractors feel that amendments to the law, such as those embodied in S. 328 are necessary to cover areas overlooked in the initial legislation and to remedy some inadequacies in the current law.

Foremost among our concerns, but by no means our ONLY concern, is the pressing need for inclusion of subcontractors under provisions of the Prompt Payment Act. This Act has had the salutary and sought effect of greatly increasing the number of on-time payments made by the Federal government. However, subcontractors on Federal construction jobs are not receiving the benefits of that law as they should. We are in desperate need of protection for subcontractors on Federal construction projects so that they, too, may be assured of prompt payment.

The Swanson-Nunn Case

Let me relate to you our own experience on a Department of Energy job in Kansas City, Missouri. We are acting as an electrical subcontractor on this job. The total amount of the contract is in excess of $5 million. Our subcontract, including change orders and completion extensions amounts to a total in excess of $800,000.

Our first invoice was submitted on Nov. 21, 1984. Since that date we have submitted timely statements - at least once a month - for work completed. Beginning with our invoice of July 31, 1985, the prime began to make only partial payment or no payment at all on those invoices. At the present time the prime is in arrears on payments totalling well over one-third the total contract price. We are currently owed more than $242,000 by the prime contractor... nearly 20% of our total net worth as a company.

Using the Freedom of Information Act, we have obtained information showing with certainty that the prime regularly has received payment in full from the Department of Energy for our electrical work, yet these funds have not been paid to us. The oldest of these unpaid invoices is now over one year past due.

We are not the only subcontractors on this job with the problem. Four other contractors have filed suit for payment under provisions of the Miller Act. However, bonding companies invariably put off any consideration of such a claim until the bonded contractor has become completely insolvent and gone out of business. The situation in which our firm and the other subcontractors on the job find ourselves is not unique. Attached to our written statement are details of this and other similar cases.

Subcontractor Prompt Payment

Our case is representative of a multitude of similar cases, many of which are included with this statement as exhibits. Taken together they show a pattern of shocking and substantial abuse of the subcontractor payment process by prime contractors on Federal work. Of course, not all prime contractors unscrupulously abuse or ignore the payment provisions of their contracts with their subs. Perhaps not even a majority do so. The number of prime contractors on Federal work who receive payment for a subcontractor's work and hold that money for extended period for their own benefit and use - meanwhile withholding payment to the sub -is prevalent enough that a Prompt Payment Act remedy is urgently required.

We strongly support the wording in Section 7 of S. 328, requiring that sub-contractors be paid promptly, as determined by prevailing industry practice, as soon as the prime contractor has been paid for the work done by the subcontractor or receive interest from the prime contractor on the overdue amount. (From 3 to 7 days is the current accepted industry payment practice - the sooner the better.)

We would recommend additionally strengthening this language to the include a provision whereby if three or more payments to a subcontracter are late, after the prime contractor has himself been paid, a requirement for direct payment of the sub-contractor from the contracting agency would be triggered. Even though our membership acts primarily as first or second tier subcontractors or as primes, we would not object to the provision being carried out to as many tiers of sub-sub contractors or suppliers as might be necessary to make sure that payments are made properly and on time.

The Privity of Contract Issue

An organization representing prime contractors has raised the issue that a law requiring prompt pay for subcontractors is an infringement on the common law right of "privity of contract" (perhaps better called "freedom to contract"). We have attached a legal advisory from the law firm of Kasimir and Ittig fully refuting this self-serving and ill-supported contention. Furthermore, the government's own legislative record is the most persuasive refutation of this argument.

The Federal government now includes nearly fifty major requirements in its contracts which it makes prime contractors "pass-through" to their subcontractors...more than double that number if you count each clause. These are in the form of special requirements or restrictions on the subcontractor, such as the compliance requirements of the Davis-Bacon Act, and include every conceivable aspect of the job.

I have included in an attachment to my written statement an example, a letter from the Office of the General Counsel of the Department of the Army to a general contractor, which states "we [the Corps of Engineers] require you [the prime contractor] to physically insert in each of your subcontracts the contract provisions relating to labor standards and any special bid conditions relating to goals for minority and female utilization; incorporation by reference does not constitute compliance." Also attached is a list of the many clauses required by law to be "passed-through" by the prime to the subcontractor in his subcontracts.

From the initial moment of agreement on a contract, the government has intruded its special requirements, regulations and mandates into the contracts between the prime contractor and his subcontractors.

These multitudes of passed-through requirements show just how fallacious the concept of "privity of contract" really is when faced with the myriad government regulations requiring pass-through of contract provisions. On Federal and Federally-assisted work the relationship between a prime contractor and his subcontractors is molded, shaped and constrained by these pass-through requirements. About all that is not passed-through is the protection of Federal contract law, which the prime contractor fervently wishes to retain exclusively for his own benefit.

It is time that the benefits as well as the restrictions of Federal law were passed through to subcontractors. We have attached to our written statement several other representative case studies where prime contractors have been paid for the work of the subcontractors, yet have not passed along that payment to their subs. Often this money has gone for other uses or been kept in accounts earning interest for the prime contractor.

Prime contractors themselves obliquely attach themselves to the fairness of our suggested change in Prompt Payment Act language. In a joint policy statement agreed to by the Associated General Contractors (AGC), the American Subcontractors Association (ASA) and the ASC, all parties agree that a prime should pay each subcontractor the amount received from the owner on his account no more than seven days after he has received payment from the owner. The American Institute of Architects (AIA) circulates a widely-used subcontract form which calls for payment to subcontractors within three days after the prime is paid. Unfortunately, primes are not willing to accept a law which would insure they live up to the principles they espouse.

To even further dispense with the concept of "privity of contract" as a bar to the Section 7 language of S. 328, it must be noted that a Federal or Federally-assisted construction subcontract cannot be construed in the same manner as a strictly private contract between a prime and subcontractor. Instead, it is a subcontract on a government project which will, as such, benefit the public. This is a special situation, and is the reason why many special conditions may be appended to that contract in the interest of advancing public policy. It is also the reason that these conditions are required to be passed on to subcontractors as part of the contract document language.

Finally, the notion of "privity of contract" is abused by the prime contractors themselves. Normally a contract is formed between two parties. One promises to deliver goods or services for a consideration from the other. When one party fulfills his obligation to peform, the other party is obligated to tender the consideration, regardless of any extraneous factors.

Prime contractors, however, like to hedge their bets. Most standard subcontract forms proffered by prime contractors call for unconditional performance by the subcontractor, but condition payment upon receipt of funds from the owner. In this manner prime contractors show themselves to be only a conduit for funds between the owner and subcontractor. As such, there is an implicit relationship directly between the subcontractor and the owner (in this case, the government).

In a recent position paper, an organization representing prime contractors took the position that the government has no business intruding in the relationship between prime and subcontractors, stating "Progress payments to subcontractors are purely a private matter."

The arrogance of such a statement in the face of existing legislation - including the Miller Act - amounts to a sheer flight of fanciful self-aggrandizement. Apparently prime contractors long for a world where they get paid promptly, but pay their subcontractors only at their whim. Such a system cannot work; indeed, the Congress saw that when it passed the Miller Act. However, even that level of subcontractor payment protection no longer serves the intended purpose.

The Miller Act - No Remedy

Today there simply is no practical way for a subcontrator to enforce the payment obligations of the prime contractor. The Miller Act, often pointed to as a panacea for subcontractors, is impractical, unresponsive to the real problem, and costly to pursue. In today's litigious society the Miller Act is a last resort without substance. It fails on several grounds:

- First, sureties want to make sure all other avenues of payment have been exhausted before they will even consider paying under provisions of a Miller Act bond. This can take years. Some sureties will simply not pay unless the non-paying prime has declared bankruptcy...and even then it can take a long time to receive payment. The months and years it may take to follow the funds through this tortuous path are another vast extension of the time during which the subcontractor must finance the labor, materials and overhead expenses already paid out for the work. During this extended period of pursuing the funds due to him, the subcontractor must operate with a decreased financial capacity, denying him new jobs he might have bid, and adding the increased costs of servicing the debt.

- Second, attornies' fees are inevitably involved. These can eat up a tremendous portion of the money which are rightfully due the subcontractor. These must be borne on top of all the other costs incurred while pursuing payment. The result is that the sub, at best, may receive only 50 cents on each dollar spent on fulfilling his contract. At this point there is no profit left in the job...only the bare hope of survival.

- Third, under certain conditions a prime may post personal securities instead of a bond under the Miller Act. Unfortunately this is not well policed, and the value of the security may be on paper only. In such cases the subcontractor is left with no recourse whatsoever.

Since this so-called Miller Act "remedy" takes years and deep financial resources to pursue, with uncertain results at best, it is of very little practical benefit to a subcontractor who more than likely will be forced out of business before any tangible benefits can be obtained from the prolonged and tortuous pursuit of payment through endless legal channels. It certainly is not public policy that subcontractors who perform work for the government should actually be BARRED from swift and fair payment for that work. Yet, in far too many cases, that is the effect of current law on subcontractors on those jobs.

I have stated Swanson-Nunn Electric Company's difficulties. We are not an isolated case by any means...and we need help. We cannot pay our bills and meet our payroll by telling our vendors, the IRS and our workers to "please wait until we get our lawsuit settled."

Now let us look at some additional problem areas of Federal construction procurement which cry out for legislative solutions.

Prompt payment on federally assisted work

Frequently delays in payment are reported on Federally-assisted work performed through grants, loans, and loan guarantees. As in the flow-through of payments from primes to subs, it is essential that on Federally-assisted work prompt payment should be accorded those who perform the work.

When contractors complete portions of their work or complete the job they certify its completion and request a progress payment or final payment. While inspection of the job by the contracting officer or his agent may be necessary to insure that certification is accurate, it should be done promptly. There should be no excuse for tying up payments in the Federal-state bureaucracy. It is in the best interests of the Federal government to make sure that payments on Federally-assisted activities are made promptly to protect the substantial interest and investment of the Federal government in the project.

Prior to enactment of the Prompt Pay Act there were cries that the process couldn't work that quickly... and that interest penalties would hamper the work of Federal agencies. Now we can expect similar contentions that those receiving Federal assistance cannot move swiftly or make the process work. However, with the force of the law requiring prompt payment or interest payments on late payments, Federal agencies, for the most part, proved up to the challenge, and were able to comply far more effectively than their own dire predictions anticipated. We believe agencies making payments to contractors and subcontractors through Federally-assisted programs likewise can be jarred into responding with much greater efficiency through the addition of a legally binding fiscal incentive - interest required on late payments.

Such an extension of the Prompt Pay law is consistent with the spirit of the law and the intent of Congress in its passage. The law was enacted to insure that businesses, particularly small businesses, receive the payments due them in a timely fashion. Congress considered inclusion of Federally-assisted activities in the Prompt Pay law prior to its enactment in 1982. However, in the interest of getting prompt pay rapidly in place in the Federal system, provisions for Federally-assisted activities were set aside for later action. Considering the success and the substantial effectiveness of the Prompt Pay Act, and with the improvements included in S. 328, that time now has come.

All too frequently construction contractors on Federally-assisted construction jobs face late progress payments and final payments for their completed work. The most notable and severe problems have been documented by the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC) on mortgage insurance programs backed by the Department of Housing and Urban Development (HUD).

A survey by NAPHCC of contractors who do HUD work indicates that 15% of progress payments are paid more than 60 days after they are due and an astounding 71% of final payments are paid later than 90 days after thge due date. A copy of this survey is attached. Frequent reports have been received from contractors who have not received their full final payment more than a year after project completion and long after residents have moved into the HUD-backed projects.

Contractors on Federally-assisted jobs have been told by HUD officials that the agency has no control over funds after they have been committed, and that they cannot dictate the terms of a contract. Yet the same Federal officals freely admit that contractual terms are rigidly dictated by Federal regulations. A letter from HUD, attached (paragraph 5), demonstrates this point. Furthermore, despite assertions by HUD that "none of the terms of the contract negotiated between a subcontractor and general contractor are dictated by HUD" (attached letter), a substantial number of contract provisions are, indeed, mandated by law and regulation. These include affirmative action requirements, Davis-Bacon minimum wage requirements and more. Attached to our statement are excerpts from HUD-5370, the general conditions of contract which include provisions for subcontracts. These are, in many ways, similar to the same requirements which must be passed-through to subcontractors on Federal projects.

HUD officials have gone so far as to suggest to contractors that they need not bid on work if they don't like the contract terms. They seem to operate according to the so-called "golden rule of construction", that is: "He who has the gold, makes the rules." HUD sets the rules for its grantees; the grantees add additional rules for prime contractors and subs; once the prime contractor has the contract, from his position of strength he dictates additional terms to subcontractors through the subcontract agreements, meanwhile passing along all the other requirements of HUD and the grantee.

Some of those same officials have even suggested that subcontractors could jointly agree not to bid jobs where subcontractor payment terms are blatantly unacceptable. This, of course, conveniently overlooks antitrust laws prohibiting such joint economic action. Subcontractors' hands are tied by the antitrust laws while HUD tells them to resist prime contractor demands and outrageous payment terms on subcontracted work.

Contractors awaiting final payment on Federally-assisted construction contracts continue to be beset with major delays in receiving payment. Again, this is especially true on Federally-assisted HUD work backed by Federal mortgage insurance. These final payments often are large payments, incorporating - as they do - any retainage that may have been withheld throughout the course of the job. It is not unusual for a contractor to have completed a job and see the project in use while still awaiting his final payment. Sometimes he is still waiting YEARS later!

Final payments, including retainage, should be paid promptly and on a line item basis to subcontractors upon substantial completion of their work. This involves development of an effective definition of the date when the final payment is due the subcontractor, so that accurate interest assessments for late paymenmts could be accurately and fairly determined. Where sums have been retained for "punch list items" (final detail work), the amount held back should be no more than the value of those items, and should be released as the items are completed.

The solution we propose to these severe payment problems is to extend the provisions of the Prompt Payment Act to Federally-assisted activities through the additional language in S. 328 as it now reads, including extension of Section 7 to Federally-assisted work. Additional language needs to be developed setting forth a clear definition of final completion. We would be happy to work with the Committee in developing appropriate language to achieve these objectives.

Prompt Certification of Completed Work

The problem generated by a prime contractor who is slow or unwilling to pay his subcontractors on time can be made even worse by a contracting officer who is slow to certify requests for payment. On construction jobs as each subcontractor completes portions of his work he submits periodic requests for payment - usually monthly (progress payments). These are payments for work that has been completed and installed. Before payment is made, a contractor must submit his invoices for the work done. The contracting officer or his agent must then certify that the work indeed has been completed. Once this invoice is certified it is passed on to the contracting agency for payment. Since it is not a proper invoice until the work has been certified, a contracting officer can bypass provisions of the Prompt Payment Act by simply delaying the certification procedure. ASC believes the Prompt Payment Act should be amended to include provisions which state that a contracting officer should have no more than five working days from receipt of a request for payment in which to review the work and certify or deny payment. If he does not act within that five-day period, the work should be considered acceptable and the invoice should be considered proper and payable under the terms of the Act.

Prompt Payment and Retainage Practice

In addition to the subcontractors' problem of slow payment, there is the problem of retainage. A retained percentage of progress payments, held by an owner or prime contractor for security reasons, is simply another aspect of a contractor not receiving prompt and full payment for work performed. Under current administrative policy the practice of withholding a percentage of a progress payment for security purposes must be justified by conditions on the job, otherwise no retainage is to be withheld. We applaud this policy as a major improvement. However, the subcontractor again is not afforded the same benefits and protections of this policy as those received by the prime contractor. A subcontractor should not have any funds retained from progress payments unless the prime contractor is also having funds withheld. Unless a subcontractor, specifically, is having problems with his work he should not be subjected to a higher level of retainage than is the prime contractor.

On the Swanson-Nunn job I used earlier as an illustration, our subcontract calls for 5% of each progress payment to be retained until the project is 50% complete, and states that an additional retainage will be withheld if the contracting agency requires a retainage from the prime. Due to the prime's poor work, that additional retainage has been imposed, and we are now suffering as a consequence of the shoddy performance of the prime contractor. The Prompt Payment Act should contain language which states that no retainage shall be withheld from construction progress payments unless a clear and present need for such a retainage has been demonstrated. This language should state that subcontractors should operate under the same retainage conditions as a prime contractor, unless specific conditions mandate the additional security.

Construction Progress Payments

The status of construction progress payments themselves have remained ambiguous under current Prompt Payment Act regulations. Even though they are payments for work completed, some agencies have interpreted them as being payments for financing purposes, which are specifically exempted from the Act. A recent "clarification" of that policy published by the Office of Management and Budget in the Federal Register does absolutely nothing to resolve this ongoing problem. We support the language in S. 328 which resolves this problem by clearly and unequivocally stating that progress payments for construction work completed are specifically covered by the Act.

Directed Modifications

Another problem in the prompt pay arena is that of directed modifications. Government construction contracts allow a contracting officer or his agent the opportunity to unilaterally change the scope of the work for the government's benefit. One method allows the contracting officer to issue a directed change order. The contractor is required to proceed, but payment for the change, called an "equitable adjustment" of the contract price, is not determined until later..quite often much later. Until the contracting officer agrees upon a price for a directed change order, invoices on that work are not considered proper and do not fall under the Prompt Payment Act even though the contractor is required to expend the money for labor, materials and overhead to carry out the change. A contracting officer concerned with cash flow can put off negotiations on a price for change orders for months...even years!

Change order costs often are incurred by a contractor long before the government can be billed for the work. Under standard Federal contract terminology, the contractor is required to proceed as directed without benefit of a set price or payment. Furthermore the change must be financed by the contractor for as long as it takes to get the contracting officer to agree to an equitable adjustment. Since the contractor is in the unenviable position of being required to perform the work without prior agreement on its worth, he is at the mercy of the contracting officer...with whom he does not even have a contractual agreement...only "passed-through" requirements to honor directed modification orders with a price to be determined later.

How many other businesses would or could operate under those circumstances? Can you imagine a restaurant serving a meal to a customer and then relying on that customer's judgement as to what the meal was worth and on his good will as to what he would pay for the meal after it had been consumed? The Prompt Payment Act should be amended to require immediate payment for work completed under a directed change order on Federal construction projects. On such changes contractors should be allowed to invoice immediately for labor, materials, and overhead. At the very least, all directed modifications (change orders) should be submitted by the contracting officer to the contractor required to perform them in writing with an estimated cost to complete included and signed by the officer or his agent.

In conclusion, I would like to thank the Committee for allowing the Associated Specialty Contractors to present their views on S. 328, proposed amendments to the Prompt Payment Act, as well as on the other additions and changes so desperately needed by specialty contractors in their quest for fair and equitable treatment in the arena of Federal procurement. We most strongly urge passage of this legislation, including the language of Section 7, providing for pass-through of provisions of the Prompt Payment Act to subcontractors, as well as inclusion of the other suggested improvements noted in this testimony. Supplementary supportive documentation for inclusion in the hearing record is attached. We would welcome the opportunity to provide any further information the Committee might request.

Thank you.

Attachment A

SWANSON-NUNN
ELECTRIC COMPANY
SINCE 1903

"IF IT'S ELECTRIC.....
CALL SWANSON-NUNN!"

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Direct Dial 812/464-3701

June 4, 1986

FEDERAL EXPRESS

Dear Sir:

On October 17, 1984, Swanson-Nunn Electric Company entered into a subcontract (No. 324-100) with Webb Mechanical Enterprises, Inc. for the electrical work involved with the Support Stores Project W-87 for the United States Department of Energy, Kansas City, Missouri. Webb's direct contract with the government was in excess of $5 million. Our contract amount with Webb was $575,000.

Webb was required to complete the project within 425 calendar days. The original contract provided by Webb for Swanson-Nunn acceptance called for a ten percent (10%) retainer. The contract Webb presented also contained a very "contractor-oriented" liquidated damage clause. We refused to accept the retainer provision, but did agree to a five percent (5%) retainer on the first 50% of the project and additional retainer if additional retainer was withheld from the contractor. Poor performance by Webb has forced the government to withhold additional retainer, and thus Webb is now holding $45,740 retention.

We also refused to agree to the liquidated damage clause contained in the contract they presented, and instead agreed to a clause written with more fairness to subcontractors.

Change orders and contract extensions have revised the contract amount to $760,307.41, and completion extensions to July 1, 1986. Webb continues slow progress and actual completion will probably be much later than July 31.

Enclosed is a report dated 6/3/86 showing the record of Swanson-Nunn invoices submitted to Webb for this project and information relating to those invoices. It is readily apparent Webb is not meeting his contractual obligations for payment on this project.

Page 2

June 4, 1986

We also have change orders not yet approved totaling $103,285.56. One of these change order requests totaling more than $92,000 has been in process more than six months, and has not yet been approved by the Department of Energy, mainly because of poor handling by Webb.

In February 1986, we accepted a change order (No. 324-100-11) which allowed Webb to defer a $68,471.91 payable for six months. (Webb accepted an 11.5% interest on this amount.) A summary of Swanson-Nunn's "investment" in this project is as follows:

1.	Withheld retainer	$ 45,740.43
2.	Payments due not yet paid	74,382.83
3.	Change orders not yet approved	103,285.56
4.	Payments requested, not paid	66,937.07
5.	Change Order No. 324-100-11	72,649.23
	Total	$362,995.12

We have received information of four suits pending against Webb Mechanical filed under the provisions of the Miller Act. They are:

Docket 86-0408-CU-W-3 filed by the W. B. McGuire Company, Inc..

Docket 86-0475-CU-W-9 filed by the Hanens Steel Company.

Docket 86-0513-CU-W-1 filed by the Berner International Company.

Docket 86-0424-CU-W-8 filed by the Standard Insulation Company.

Contractors working on the job we have been on include:

Midwest Mechanical Co.
Seibolt Swinney Sheet Metal Co.
The National Concrete Company

All have had very, very, very slow payments from Webb. All of these three contractors have walked off the job several times because of slow pay.

Bob, we also enclose with this correspondence a letter from our attorney Gerry Ittig to the Webb firm, which simply suggests additional legal fees we anticipate as a result of our experience with Webb.

Page 3

June 4, 1986

Another facet of problems contractors encounter on government projects is discussed in David Buttrum's October 5, 1983, letter to the Office of Management and Budget. It discusses ways government contract administrators can delay processing of contract modifications, thereby "holding" a subcontractor's money. This matter, too, needs to be handled in any anticipated prompt payment act.

Thank you, Bob, for your involvement in efforts to help electrical subcontractors. It is apparent from our experience with Webb such federal legislation is really needed.

We at Swanson-Nunn are very supportive of your efforts and offer any assistance you might request.

Sincerely,

Jack

Jack Buttrum
President

JB/b

Enclosures

P.S. Because of conversations with several Department of Energy Contract Administrators and because of our use of the Freedom of Information Act, we have certain knowledge that Webb received payments for electrical work completed and yet did not pay Swanson-Nunn.

Attachment A (cont'd)

REPORT DATE: 06/03/86

SWANSON NUNN ELECTRIC COMPANY, INC.
SUMMARY OF OPEN ACCOUNT BALANCE
WEBB MECHANICAL ENTERPRISES - SUBCONTRACT #324-100

INVOICE #	INVOICE DATE	INVOICE AMOUNT	PAYMENT DATE	AMOUNT PAID	AMOUNT DUE	AGE OF INVOICE JUNE 3, 1986
8200-1	11/21/84	22495.76	01/29/85	22495.76	0	
8200-2	12/31/84	38579.13	02/22/85	38579.13	0	
8200-3	01/24/85	33081.35	03/21/85	33081.35	0	
8200-4	02/22/85	103654.7	04/22/85	103654.7	0	
8200-5	03/22/85	28155.93	06/18/85	28155.93	0	
8200-6	04/25/85	30754.36	06/28/85	30754.36	0	
8200-7	05/24/85	64867.2	08/12/85	64867.2	0	
8200-8	06/28/85	93955.68	10/09/85	93955.68	0	
200-9	07/31/85	66624.02	11/06/85	33312.01	33312.01	307
8200-10	08/29/85	28835.43	12/17/85	14533.57	14301.86	278
8200-11	09/23/85	11085.23			11085.23	253
8200-12	10/21/85	15340.99			15340.99	225
8200-13	11/26/85	12972.73	01/22/86	12972.73	0	
8200-14	12/26/85	71034.27	01/22/86	45846	25188.27	159
8200-14A	12/26/85	20800.36	05/13/86	1120.58	19679.78	159
8200-15	01/23/86	23885.6	05/13/86	5310.24	18575.36	
8200-15	01/23/86		05/13/86	18575.36	0	
8200-16	02/27/86	27357.53	05/13/86	27357.53	0	
8200-17	03/24/86	19919.42			19919.42	71
8200-18	04/24/86	52156.21			52156.21	40
8200-19	05/27/86	4410			4410	7
TOTAL		769965.9		574572.13	213969.13	

Attachment B

"IF ITS ELECTRIC.....
CALL SWANSON-NUNN"

SWANSON-NUNN
ELECTRIC COMPANY
SINCE 1903

CONSTRUCTION · ENGINEERING · WHOLESALE SUPPLIES · MOTOR REPAIR

400 S E EIGHTH STREET · P O BOX 508 · EVANSVILLE INDIANA 47703 · TELEPHONE (812) 424-7931

Direct Dial 812-464-3715

October 5, 1983

Mr. Marvin E. Saunders
Office of Management and Budget
Finance and Accounting Division, Room 10235
New Executive Office Building
Washington, D. C. 20503

Re: Federal Prompt Payment Act

Gentlemen:

Through the National Association of Credit Management Newsletter, I learned that your office is soliciting information regarding company experiences with the Federal Prompt Payment Act.

Although we support enthusiastically the issuance of OMB Circular A-125 and the Prompt Payment Act, our experience as related to construction has not been satisfactory. Swanson-Nunn Electric Company's main exposure to government contracts is primarily directed toward Corps of Engineers' construction work as a subcontractor to a prime contractor. Our dealings have been second tier. However, we have found that through contract administration of work by the Corps of Engineers, and the Contracting Officer's use of directed modifications and then delaying an agreement that settles the cost of the directed modification, the Corps is able to keep the directed mod from becoming an Amendment to the contract. The Corps, then, is able to delay payments to the contractor and subcontractor and thwart the provisions of the Act. It is apparent that there should be further clarification made to Circular A-125 to define what "a proper invoice" is. And perhaps, tie that clarification in some way to work accomplished through Contracting Officer directed modifications. This would allow contractors to be paid for some or all of their direct costs associated with this type of extra work.

In our case, it has taken up to ten months to receive payment for work accomplished and done as a directed modification. Delays by the government in issuing a contract amendment kept us from using the provisions of the Prompt Payment Act.

SWANSON-NUNN
ELECTRIC COMPANY

Mr. Marvin E. Saunders
October 5, 1983
Page II

I commend the Office of Management and Budget for their active interest in helping the Government become a "good" customer. I hope that although my comments appear to be negative, that the OMB continues to enforce and support ways to insure prompt payment to suppliers and contractors. In this era of super-high interest rates, cash flow is the difference between surviving and failing.

Thank you for this opportunity to express to you my thoughts regarding this matter.

Sincerely,

David A. Buttrum
Vice President, Construction

DAB:EMS

Joint Policy Statement

JPS-1
(Revised)

PROMPT PAYMENT

Undue delays by owner, architects/engineers, general contractors, subcontractors, and sub-subcontractors in processing amounts due to general contractors, subcontractors, sub-subcontractors, and suppliers, or in making timely payments of these amounts, impose hardships and improper financing burdens on the contractors and suppliers and amount to extensions of credit by the contractors and suppliers to their respective higher tiers.

Accordingly, it is the policy of Associated General Contractors and the American Subcontractors Association and the Associated Specialty Contractors that all payments must be made on all contracts promptly. This should include payment for all labor, services, and materials stored on the job site or other approved storage sites as of the closing date of requisitions. This applies to both progress payments and final payments.

All local chapters of the Associated General Contractors, the American Subcontractors Association and the Associated Specialty Contractors are urged to make efforts, singly or cooperatively where possible to persuade all owners, architects/engineers, general contractors, subcontractors and sub-subcontractors to adopt and adhere to this policy in the conduct of their business.

The following schedule of billings, certificates and payments by various participants in the construction process is recommended.

The schedule assumes normal trade contract terms allowing monthly progress payments for work performed and materials suitably stored through the end of the month. This schedule does not refer to payments to suppliers who are not subcontractors.

It is important to note that along the sequence of events, any recipient of a payment request who takes exception to an item of billing should immediately contact the initiating party by telephone and attempt to resolve the matter. Failing resolution, the party taking exception should notify the other party in writing the reasons for the action.

Day of Calendar Month	**Event**
20th	Sub-subcontractors request payment from subcontractors.
25th	Subcontractors request payment from contractor, incorporating the sub-subcontractor's request in the billing.
1st	Contractor submits to the owner's representative an itemized application for payment with the necessary supporting data, covering the monthly progress of the entire contract being performed.
5th	The owner's representative issues the certificate for payment to the owner for the amount requested.
10th or sooner	The owner makes payment to the contractor for the amount certified by the owner's representative.
No More Than 7 Days After Receipt	The contractor pays each subcontractor the amount received from the owner on his account promptly but not later than seven days after receipt.
No More Than 7 Days After Receipt	Each subcontractor pays each sub-subcontractor the amount received from the contractor on his account promptly but not later than seven days after receipt.

The schedule should be adjusted by making appropriate billings and payments on the last working day prior to any listed Saturday, Sunday or holiday. It is also recommended that collection efforts be commenced immediately following the day any payment due was not paid.

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Index No. 2170; 19M; 12/84

Attachment D

LIST OF FAR PROVISIONS

REQUIRED TO BE PASSED-THROUGH TO SUBCONTRACTORS

1. FAR 52.202-1 -- DEFINITIONS
2. FAR 52.236-8 -- OTHER CONTRACTS
3. FAR 52.236-7 -- PERMITS AND RESPONSIBILITIES
4. FAR 52.203-3 -- GRATUITIES
5. FAR 52.203-5 -- COVENANT AGAINST CONTINGENT FEES
6. FAR 52.228-5 -- INSURANCE -- WORK ON A GOVERNMENT INSTALLATION
7. FAR 52.236-21 -- SPECIFICATIONS AND DRAWINGS FOR CONSTRUCTION
8. FAR 52.236-15 -- SCHEDULES FOR CONSTRUCTION CONTRACTS
9. FAR 52.236-5 -- MATERIAL AND WORKMANSHIP
10. FAR 52.236-14 -- AVAILABILITY AND USE OF UTILITY SERVICES
11. FAR 52.236-10 -- OPERATIONS AND STORAGE AREAS.
12. FAR 52.236-9 -- PROTECTION OF EXISTING VEGETATION, STRUCTURES, EQUIPMENT, UTILITIES, AND IMPROVEMENTS
13. FAR 52.236-13 -- ACCIDENT PREVENTION
14. FAR 52.236-12 -- CLEANING UP
15. FAR 52.245-3 -- IDENTIFICATION OF GOVERNMENT-FURNISHED PROPERTY
16. FAR 52.246-12 -- INSPECTION OF CONSTRUCTION
17. FAR 52.225-5 -- BUY AMERICAN ACT --CONSTRUCTION MATERIALS
18. FAR 52.208-1 -- REQUIRED SOURCES FOR JEWEL BEARINGS AND RELATED ITEMS
19. FAR 52.247-63 -- PREFERENCE FOR U.S. - FLAG AIR CARRIER
20. FAR 52.247-64 -- PREFERENCE FOR PRIVATELY OWNED U.S. - FLAG COMMERCIAL VESSELS
21. FAR 52.223-2 -- CLEAN AIR AND WATER
22. FAR 52.222-26 -- EQUAL OPPORTUNITY
23. FAR 52.222-35 -- AFFIRMATIVE ACTION FOR SPECIAL DISABLED AND VIETNAM ERA VETERANS

FAR PROVISIONS cont.

24. FAR 52.222-36 -- AFFIRMATIVE ACTION FOR HANDICAPPED WORKERS
25. FAR 52.222-27 -- AFFIRMATIVE ACTION COMPLIANCE REQUIREMENTS FOR CONSTRUCTION
26. FAR 52.219-8 -- UTILIZATION OF SMALL BUSINESS CONCERNS AND SMALL DISADVANTAGED BUSINESS CONCERNS
27. FAR 52.219-9 -- SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS SUBCONTRACTING PLAN
28. FAR 52.219-13 -- UTILIZATION OF WOMEN-OWNED SMALL BUSINESSES
29. FAR 52.220-3 -- UTILIZATION OF LABOR SURPLUS AREA CONCERNS
30. FAR 52.220-4 -- LABOR SURPLUS AREA SUBCONTRACTING PROGRAM
31. FAR 52.243.4 -- CHANGES
32. FAR 52.214-26 -- AUDIT - FORMAL ADVERTISING
33. FAR 52.214-27 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING
34. FAR 52.214-28 -- SUBCONTRACTOR COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING
35. FAR 52.215-2 -- AUDIT - NEGOTIATION
36. FAR 52.215-22 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA
37. FAR 52.215-24 -- SUBCONTRACTOR COST OR PRICING DATA
38. FAR 52.215-1 -- EXAMINATION OF RECORDS BY COMPTROLLER GENERAL
39. FAR 52.232-17 -- INTEREST
40. FAR 52.249-10 -- DEFAULT TERMINATION OF THE CONTRACTOR
41. FAR 52.233-1 -- DISPUTES
42. FAR 52.204-2 -- SECURITY REQUIREMENTS
43. FAR 52.222-4 -- CONTRACT WORK HOURS AND SAFETY STANDARDS ACT - OVERTIME COMPENSATION-GENERAL
44. FAR 52.223-3 -- HAZARDOUS MATERIAL IDENTIFICATION AND MATERIAL SAFETY DATA
45. FAR 52.227-4 -- PATENT INDEMNITY-- CONSTRUCTION CONTRACTS
46. FAR 52.227-1 -- AUTHORIZATION AND CONSENT
47. FAR 52.227-2 -- NOTICE AND ASSISTANCE REGARDING PATENT AND COPYRIGHT INFRINGEMENT
48. FAR 52.243-3 -- VALUE ENGINEERING - CONSTRUCTION
49. FAR 52.22301 -- CLEAN AIR AND WATER CERTIFICATION

Attachment E

Nathan Alterman Electric Co.

June 11, 1986

Re: Senate Committee Hearings
Slow Pay to Subcontractors

Gentlemen:

We have reviewed several government projects where the pay was exceedingly slow by the General Contractor. Please note as we discussed that most jobs done by reputable area contractors are paid within a 30 day period. However, some contractors have in-house policies of not paying for 60 days, and thus they have operated off of the Subcontractor's money for at least 30 days.

Some examples of these jobs are as follows:

Job #1

Project: Health Lab
Location: Brooks Air Force Base, Texas
Contract Number: DACA63-84-C-0143
Engineer: U. S. Army Corps of Engineers
General Contractor: Wallace L. Boldt, General Contractor
Subcontract Amount: $ 338,817.00
Scope of Work: Electrical subcontract

Request Number	Amount	Request Date	Pay Date	Age
1	$ 2,752.00	10/23/84	12/31/84	68
2	5,930.00	11/14/84	01/30/85	76
3	23,865.00	12/13/84	02/19/85	66
4	21,680.65	01/25/85	06/17/85	142
5	10,278.00	03/22/85	06/17/85	85
6	(3,910.00)	04/16/85	06/17/85	61
7	14,773.00	04/24/85	07/25/85	91
8	8,814.00	05/21/85	07/25/85	64
9	47,427.00	06/21/85	08/23/85	62
10	50,821.35	07/23/85	09/20/85	57
11	35,989.00	08/21/85	10/18/85.	57
12	22,835.00	09/23/85	11/25/85	62
13	34,677.00	10/23/85	12/27/85	64
14	7,499.00	11/20/85	01/29/86	69
15	3,297.00	12/18/85	02/26/86	68
16	4,753.00	01/22/86	03/24/86	62

PO BOX 17426 SAN ANTONIO, TEXAS 78217
(512) 342-9311

Request Number	Amount	Request Date	Pay Date	Age
17	4,178.00	02/24/86	04/28/86	64
18	923.00	03/24/86		
19	9,356.27	05/19/86		

Average Age = 72 days
Interest Cost to Date: $ 3,930.40
Percent of Contract to Date: 1.2%

* * * * * * * * * * * * * * * * * * *

Job #2

Project: Air Traffic Control Tower and Base Building
Location: San Antonio International Airport, Texas
Contract Number: DIFA-83-13-0021
Owner: Department of Transportation, Federal Aviation Administration, Southwest Region, Ft. Worth, Texas
General Contractor: B. B. Andersen Construction Co., Topeka, Kansas
Subcontract Amount: $ 457,858.72
Scope of Work: Electrical Subcontract

Request Number	Amount	Request Date	Pay Date	Age
1	$ 7,100.00	07/22/83	10/25/83	93
2	0.00	08/08/83		
3	2,520.00	08/24/83	10/25/83	61
4	29,025.00	09/22/83	11/09/83	47
5	10,530.00	10/21/83	11/28/83	37
6	129,735.00	11/23/83	02/16/84	83
7	56,475.00	12/21/83	03/29/84	98
8	4,275.00	01/17/84	03/29/84	72
9	20,700.00	02/15/84	03/29/84	44
10	18,675.00	03/19/84	05/07/84	48
11	3,375.00	04/24/84	05/31/84	37
12	12,600.00	06/18/84	08/01/84	43
13	9,450.00	07/19/84	08/17/84	28
14	48,650.00	08/20/84	01/07/85	137
15	5,750.00	09/19/84	01/07/85	108
16	10,167.00	10/17/84	02/06/85	109
17	4,130.00	11/12/84	02/06/85	84
18	9,512.00	12/17/84	02/06/85	49
19	20,453.00	01/21/85	05/06/85	105
20	3,039.00	02/21/85	11/18/85	267
21	10,396.00	03/21/85	06/06/85	75
22	66,020.00	05/17/85	11/26/85	189
23 Final	(24,008.28)	09/30/85	11/26/85	56

Average Age = 85 days
Interest Cost: $ 10,746.00
Percent of Contract: 2.3%

Job #3

Project:	800 Member Army Reserve Center
Location:	Fort Sam Houston, Texas
Contract Number:	DACA63-80-C-0077
Owner:	Department of the Army
General Contractor:	Fortec Constructors, Coral Gables, Florida
Subcontract Amount:	$ 245,870.00
Scope of Work:	Electrical Subcontract

Request Number	Amount	Request Date	Pay Date	Age
1	$ 5,477.00	06/02/80	*	
2	21,054.00	06/25/80	*	
3	39,550.00	07/29/80	10/17/80	78
4	9,637.00	08/27/80	10/06/80	39
5	15,528.00	09/24/80	11/12/80	48
6	16,176.00	10/20/80	*	
7	21,825.00	11/24/80	01/30/81	66
8	13,885.00	12/30/80	03/02/81	62
9	16,772.00	01/31/81	03/16/81	45
10	21,572.00	02/28/81	04/22/81	54
11	21,582.00	03/31/81	05/26/81	55
12	11,971.00	04/30/81	07/28/81	88
13	13,591.00	05/31/81	09/11/81	100
14	2,072.00	06/30/81	09/18/81	78
15	2,417.00	07/31/81	**	

* These dates were not verifiable.
** Part of final pay was written off to bad debts.

Average Age = 62
Known Interest Cost: $ 2,182.50
Percent of Contract: .9%

Most contracts read that the monthly estimate is due by the 25th for work through the 30th, and the General Contractor (GC) is to receive payment from the Owner by the 15th or 20th. Allowing three days for processing and delivery (the checks should be ready for signature when the GC receives payment), then the normal delay from billing to payment should be 23 to 28 days.

A delay of 30 days in payment will result in the Subcontractor having to access his line of credit and incur administrative costs above and beyond the interest cost that an interim loan may cost him. We have attempted to show the interest cost on the above examples based upon an interest rate of 12 percent for late payments beyond 30 days. Though these interest costs in some instances may appear low, the margins allowed on jobs today do not allow unwarranted delays in payment.

I would also like to stress that it is not the large contractor who hurt the most as they may have legal staffs and generally deeper pockets to absorb this added cost. However, as we are seeing all too well today and will see even more in the immediate future, the small businessman, who must take these jobs to survive and cannot afford to hound the GC for prompt payment, is the most likely to fail due to the added costs and especially as these overdue payments become uncollectible.

Please let me know if I can be of further assistance.

Yours very truly,

NATHAN ALTERMAN ELECTRIC CO.

Daryl Klecka/ns

Daryl H. Klecka
President

DK/ns

Attachment F

QUINT CITY ELECTRIC, INC.
1501 - 17TH STREET
EAST MOLINE, ILLINOIS 61244
(309) 755-5015

June 13, 1986

Dear Sirs:

In response to your inquiry with regards to construction pay requests from General Contractors involved with Government Contracts, I wish to submit the following:

We, Quint City Electric, Inc., have for the past 2½ years done a substantial volume, in excess of One Million Dollars, of work for General Contractors on Corp of Engineers & Facilities Projects at the Rock Island Arsenal. It has been our experience that punctual, within 60 days, payment from the General Contractors depends entirely upon the integrety and financial condition of said contractor, as any contract a sub contractor has is with the General Contractor and not the Government. The General Contractor can do as he wishes with his subs, the Government could care less, and we have so been informed of this by various Procurement Personnel. We are at the present trying to collect for a project, No. D-AAA08-85-C-0161, which we started on August 21, 1985 and completed April 19, 1986. The General Contractor has been paid in full and to date has only paid us 35% of our contract price. The excuse given is that the Government has not, as yet, released monies to him. Checking with Procurement Personnel, we were informed they could not release information relative to disbursements and we would have to deal with the General Contractor directly. The Government, it would seem to me, aids and abets the unscrupulous contractor. The current balance due and owing, since 4-21-86, is in excess of Twenty Six Thousand Dollars. As can be readily seen, Quint City Electric, Inc. has been forced to play financier to the General Contractor, and being a small business, government qualified, this causes a major cash flow problem.

Concurrent with the aforementioned project, we are also employed on Contract No. DACA 27-85-C-0083. On this project we have experienced problems of a more severe nature and scope. On this project which is a 100% set aside for small business, we are a third tier sub contractor. What a situation for a small business to occupy. You have all the liability and exposure and the first and second tier contractors reap all the rewards. The local economy, being what it is, and knowing we possessed the expertise to perform the necessary work, were the factors leading to the decision to quote this project. What an error in judgement! Within the first week of the project we discovered the Contracting Officers Representative could require anything, no matter how ludicrous, and we would, by contract, be required to do as requested. Our only recourse for reimbursement being to file a claim for work which we considered to be beyond the scope of the contract. The filing of a claim and a decision of the same require a substantial length of time, 9 months to 18 months, and the requirement to still perform the work in question causes a severe cash flow problem which I am sure most small businesses could not cope with. We are presently financing the aforementioned project in the six figure amount. Thanks to a good credit rating and banking institutions that have confidence in us, we are managing to survive, but have been forced, due to cash flow problems, to restrict our normal workload, thereby reducing our Gross Sales. The Government itself has put us in this position. This was not effected through errors which we made, but by Government Red Tape and incompetence. Subsequent to filing our claim, it was brought to our attention that twice before, exact similar projects performed within the last five years at the same installation, have been performed. In both cases the Electrical Contractors have had to file similar claims. The bidding documents and specifications have not been significantly changed and the same problems exist. As to the prior Electrical Contractors, one was forced out of business and the other has to date, not quoted a Government project. The end result of these policies will have the effect of prohibiting small business concerns from quoting Government projects, thereby reducing competition and increasing the cost of Government projects. As can be readily ascertained from the two aforementioned projects, Quint City Electric, Inc., due to our involvement on Government projects, has had to finance in excess of One Hundred and Twenty Six Thousand Dollars ($126,000.00). This is something no small business should be forced nor expected to endure. Further evidencing our contention of increased project costs is the ReArm Phase Three Project bid on May 29 of this year, of the Nineteen (19) General Contractors who procured plans, only One (1) responded with a Quote, which incidently was Nineteen Million Dollars ($19,000,000.00) higher than the Government estimate.

It is my concerted opinion that unless appropriate changes are effected, as to Government control of General Contractors and Government personnel responsible for the overseeing of construction projects, they will destroy the lifeblood of America, the small businessman. The Government, it would seem, should have the expertise on staff to act as their own Project Manager, it has been our experience that they do this anyway. As their own Project Manager, all contracts would be direct to the respective contractors, thereby permitting the Government to excercise more control of the individual contractors and promote a harmonize construction atmosphere.

We, Quint City Electric, Inc. will, upon request, provide documentation to any allegations contained herein and if desired submit to a complete audit of any and all prior and current Government Contracts to further evidence our sincerity to the problems involved.

In summation, I submit the aforementioned projects are the rule, not the exception, concerning Government Contracts. They are not unique to our firm, as every Electrical Contractor whom has performed construction at the Rock Island Arsenal can relate many horror stories of his own. I mention the Rock Island Arsenal because this is the only Government Facility which our firm has been involved with and thereby have first hand knowledge with regards to sub contracting. I would also wish to pose a question, with the local economy being what it is, and there being in excess of Forty (40) qualified Electrical Contracting Firms in the area, why are there but Four (4) or Five (5) firms which quote work at the Rock Island Arsenal, is a voluntary closing of a company preferred to a forced closing?

Respectfully Submitted

Gerald T. Baker

Gerald T. Baker
President

GTB:law

Attachment 5

W. K. JENNINGS ELECTRIC CO., INC.
PHONE (512) 834-8677 1707 DUNGAN LANE
Austin, Texas 78754

June 6, 1986

Dear Sir:

I am furnishing the following information.

We serve primarily as sub-contractor on larger government projects. Therefore, we are subject to the disposition of the General Contractor as it pertains to when we get payments and the retainages withheld.

As a practical matter, our company is generally paid by the General Contractor within 50 days of our invoice. However, as you may be aware, the Corps of Engineers has done away with the requirement of withholding retainage from the General Contractor. In most cases, however, the General Contractors still withhold from their subs either five or ten percent retainage until the project is complete.

Since we as subcontractor have already bonded the project, we are in essence financing the General Contractor to the extent of the retainages withheld. This in turn forces us to raise our price to some extent in order to cover the additional cost of financing.

We are showing below, as examples only, some of our most recent projects performed as a sub-contractor for the Corps of Engineers.

Contractor	Contract Price	Retainage % Withheld
Wilmac Construction Co.	$ 342,000.00	10%
RGM Construction Co.	120,974.00	10%
Goolsby Building Corp.	264,452.00	5%
Goolsby Building Corp.	351,022.00	5%
Chaney-Cox Construction Co.	244,000.00	10%
Emerson Contraction Co.	183,000.00	10%
Clearwater Construction Co.	1,900,000.00	10%
T. H. Taylor, Inc.	689,000.00	10%

All of the above projects are well on their way to completion except for the Clearwater project. As you can see, we have a lot of money tied up in retainage which we believe may not be withheld from the General Contractors.

Yours truly,

Charles R Baker

Charles R. Baker
Secretary-Treasurer

CRB/me

Attachment H

NEC THE NORWALK ELECTRIC COMPANY

Electrical Contractors Since 1919 25 Elizabeth Street South Norwalk, CT 06854 Phone: (203) 853-9620

ROBERT WERME, President

SAL SALVATO, Vice President

March 11, 1987

Dear

I urgently request that you support Senate Bill S.328 which is an amendment to to 1982 Prompt Payment Act calling for Prime Contractors to pay their Subcontractors within seven days after receiving payment from the government or pay interest on any overdue amounts.

Getting paid promptly is the most serious concern faced by Specialty Contractors in the construction industry. We perform over 85% of the work on any construction project; we provide the labor force and must meet substantial payrolls each week. When the General Contractor receives payment, the bulk of the dollars belong to the many small businesses performing the actual work.

It is a sad commentary on our industry when we find the AGC (Associated General Contractor) actively resisting the passage of a law that would give Subcontractors the right to timely payment. Their efforts in this matter are a strong indication that they don't want to be held liable when they don't pass through the funds which rightfully belong to others.

Senator, this is a very serious matter. We are very labor-intensive, resulting in large payroll obligations weekly. WE MUST GET PAID ON TIME!

My company is presently performing $300,000 worth of electrical work for an addition to a local police station. We are a "Subcontractor" on the job; the payment schedule in our contract calls for progress payments each month. A requisition is submitted by the 25th of the month and payment is due between the 15th and 20th of the following month. We have yet to receive a payment within that time frame, and we have been working on this project for five months. We have been forced to borrow short-term money, which is VERY COSTLY, along with reducing the profitability of the job.

S.328 would encourage General Contractors to pay their "Subs" on time, knowing that if they do not, they will be assessed a financial penalty.....monies from their own pockets!

PLEASE SUPPORT the largest single industry in the United States, the Subcontracting Industry, by voting IN FAVOR OF S.328.

Thank you very much for your consideration.

Very truly yours,

Robert Werme

Robert Werme
President
RW/ne

Attachment I

DELTA LINE
CONSTRUCTION CO.

July 2, 1986

N E C A
Government Affairs Services
7315 Wisconsin Avenue
Bethesda, MD 20814

Re: S 2479

Gentlemen:

As you might imagine, the electrical construction industry is very concerned about the amendments to the prompt payment act.

Our company feels that passage will improve small business growth. The present system offers little if any protection as a subcontractor.

More specifically, our company has participated as a subcontractor in Federal Project BRM-7065(102). During the first eight months of this two year project the N. J. D. O. T. paid for material at site (approximately $600,000.00). After receipt, the prime contractor waited three to six months to pay, and held an additional 10% retainage.

The work complete portion of the contract ($725,000.00) follows the same scenario. Repeated attempts for state intervention failed. Yet the prime contractor continues to attest to full subcontractor payment.

We don't have to tell you about the interest rates over the past two years. The financial burden of such practices stiffles the competitive spirit and escalates costs.

You may note from our letterhead that we are a women owned business. We have never asked for special treatment, only fair treatment. The passage and enforcement of S-2479 may be one of the vehicles to keeping small businesses alive. We ask for your support.

Sincerely,

DELTA LINE CONSTRUCTION CO.

Susan E. Houde, President

SEH/fm

R.D. 2, BOX 106, PLEASANTVILLE, NEW JERSEY 08232 (609) 927-2785

AN EQUAL OPPORTUNITY EMPLOYER & WOMAN OWNED BUSINESS

Attachment J

A & M ELECTRIC, INC.
2306 COMMERCE ST., P.O. BOX 2862, LA CROSSE, WI 54602-2862
(608) 781-6175

March 9, 1987

Dear

As a small electrical contractor in western Wisconsin, I want to tell you of my strong support for Bill S.328 and the provisions which gives sub-contractors the right to timely payments.

At the present time, we are finishing an office building project for a city Housing Authority. Though we first put men on the project in mid-November, our first check did not arrive until late January and then only after several phone calls to the general contractor, who had already been paid weeks before.

In those ten weeks, I still had a payroll to meet and material to pay for. When you have no income from those job costs,those obligations are met only by borrowing money and that interest cost comes right off my profit column and into the banks. Chasing down payment also ties up personnel who could otherwise be getting the next billing out. It may also mean I can not start another project, because all my capitol is tied up financing the first one to completion. So rather than hiring another crew, I keep only one crew busy and that means not enough work for everyone. And that spirals down to every thing.

So please, support passage of S.328 with the sub-contractors provisions included and intact.

Sincerely,

A & M ELECTRIC, INC.

Alan W. Helgeson
President

AWH/kd

Attachment K

KASIMER & ITTIG, P.C.
ATTORNEYS AT LAW
1801 EIGHTEENTH STREET, N. W.
WASHINGTON, D. C. 20009
(202) 387-5508
CABLE ADDRESS
BUILDLAW
WASHINGTON, D.C.

VIRGINIA OFFICE
2110-D GALLOWS ROAD
VIENNA, VIRGINIA 22180
703-893-3914

MARYLAND OFFICE
MONTROSE OFFICE CENTER
6001 MONTROSE ROAD
SUITE 700
ROCKVILLE, MARYLAND 20852
301-984-8222

March 12, 1987

Mr. Daniel G. Walter
Executive Director
Associated Specialty Contractors, Inc.
7315 Wisconsin Avenue
Bethesda, Maryland 20814

Re: Proposed Prompt Payment Act Revisions

Dear Dan:

You have asked me to investigate the question of whether certain proposed revisions to the federal Prompt Payment Act are improper as invading a general contractor's "freedom to contract." In particular, the issue is whether the Government may insert a requirement, as part of its standard contract forms, that a general contractor pay its subcontractors within a specified period of time after it has been paid by the Government. Apparently, a contention has been put forward to the effect that such a requirement somehow illegally interferes with a general contractor's relationship with its subcontractors.

In analyzing this issue, it is as important to understand what the proposal does not do as what it does. The proposal does not affect the means or methods of performing the contracted work, nor does it create the sometimes intrusive requirements of existing regulatory mandates on record keeping, hiring and pay scales, insurance and bonding. In concept, the proposal is not unique as there except for an enforcement mechanism for existing subcontractor rights. In this regard it is difficult to understand a contention made against the proposal that although subcontractor payment rights must be acknowledged as a matter of law, it is somehow wrongful for the Government to assure that those rights are enforced.

The Government has a real interest in insuring prompt payment to subcontractors. Non-payment and late payment to subcontractors create a serious risk of delay or default by the subcontractors, thereby endangering the projects. Indeed, the widely used AIA subcontractor terms and conditions permits a suspension of the work and termination in the event of non-payment. In private construction, owners impose a comparable requirement that the general contractor submit proof of current payment to subcontractors and suppliers, often through the use of partial waivers and releases of lien, as a condition precedent to receiving additional funds. That is, the contractor will receive no money if it has not paid its subcontractors.

The seriousness of the concern over this payment issue has been recognized by states and municipalities in their contract. For example, since 1979, Virginia has included the following prompt payment language in its General Conditions of the Contract for Capital Outlay Projects (GS Form E&B CO-7):

> 44. Payments by Contractor
>
> Except in cases of bona fide disputes, or where the Contractor has some other justifiable reason for delay, the Contractor shall pay:

trustee, are severely limited. Some states, including Virginia, have made it a crime for a general contractor to betray that trust by commingling those subcontractor payments or using them to pay other creditors.

In sum, there appear to be no legal obstacles to the proposed revisions to the Prompt Payment Act. Moreover, there appear to be no "freedom to contract" issues involved.

If you have any questions or comments, please call me.

Very truly yours,

Gerard W. Ittig

GWI/mfw

Attachment L

SEVERE PAYMENT DELAYS ON HUD CONTRACTS

Following are results of a survey of members of the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC) who do federal work for the Department of Housing and Urban Development. The survey was conducted during the summer of 1985.

Approximately 700 surveys were sent to the network of contractors who perform HUD work. Of those, 85 were returned indicating they no longer do HUD work.

There were 87 usable responses by contractors who continue to perform work for HUD either through direct contracts or subcontracts with HUD or through federally assisted jobs.

26	Do primarily service work and/or small contracts
41	Do large jobs
20	Type of work not provided
87	Total responses

Generally, those who do service work and small contracts are satisfied. There was almost never retainage held and payment averaged 31 to 45 days. Contractors were generally satisfied with their HUD office and personnel.

For contractors who perform large jobs, HUD treatment was outrageous.

A) Retainage was almost always held at 10 percent. Final payment may take up to 15 months (Federal policy on direct federal construction indicates retainage should not be withheld routinely, but on a case by case basis.)

B) Median time for payment was 46 to 60 days days with several contractors reporting that payment took over 90 days.

C) The biggest problem cited was slow payment on progress payments and retainage. Two other major problems were paperwork and slow decision making.

Length of Time for NAPHCC Contractors to Get Paid

	Progress Payments	Final Payments
30 days or less	27%	-
31-45 days	32	7%
46-60 days	23	11
61-90 days	10	11
more than 90 days	5	71

DL/jat/3001G

Attachment M

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING-FEDERAL HOUSING COMMISSIONER

MAY 15

[illegible] 21 [illegible] 00

Mr. Dennis Lavellee, CAE
Director of Government Affairs
National Association of Plumbing,
Heating-Cooling Contractors
180 S. Washington Street
Falls Church, VA 22046

Dear Mr. Lavellee:

This is in response to your January 20, 1986 letter to Silvio J. DeBartolomeis, former Deputy Assistant Secretary for Multifamily Housing Programs, concerning the retainage of a percentage of construction progress payments and prompt payment of vouchers.

We assume that the situations you describe are not occurring under direct HUD contracts. The Federal Acquisition Regulation (FAR) provides for a flexible policy regarding the 10 percent withholding of construction progress payment and we encourage our contracting officers to recognize satisfactory performance and permit the waiver of any payment withholding on a case-by-case basis.

HUD's contracting officers are also expected to be very sensitive to the requirements of the Prompt Payment Act. Late payments are sometimes made, but they are closely monitored. As for payments of penalties associated with the 10 percent progress payment withholding, penalties could only be paid for properly billed amounts covering acceptable, completed work. The Prompt Payment Act is not applicable to subcontractors; therefore, unless the FAR is legislatively changed, the prompt payment provisions do not "flow thru" to subcontractors.

Provisions applicable to retainage of progress payment and prompt payments during, and upon completion of, construction differ when HUD is the mortgage insurer or lender in lieu of the contracting agent.

On projects receiving insurance of construction advances and projects with direct loans from HUD, Federal Regulations require a 10 percent retainage from construction progress payments. This retainage is normally held until construction is complete and the general contractor and mortgagor complete their cost certifications and take other necessary steps to permit final endorsement. When the general contractor's performance warrants, HUD Field Office Managers may release 50 percent of the holdback provided that construction has reached 90 percent completion. An authorization of additional releases can be obtained with the written consent of the surety and the Office Manager's assurance that failure to do so would probably result in a default of the construction loan.

HUD Field Offices are expected to place priorities on processing contractor's requisitions. These funds are released by the mortgagee to the mortgagor in projects involving mortgage insurance and by HUD through the Treasury Department to a depository and then to the Borrower in Section 202 projects for payments to general contractors and for other related costs. The Department relies on certifications by the mortgagor and general contractor that appropriate employees have been paid.

None of the terms of the contract negotiated between a subcontractor and general contractor are dictated by HUD. It is incumbent upon the subcontractor to protect itself in the event it does not receive its payments in accordance with the terms of its contract. Although we cannot assume the role of protector of subcontractors, where there is evidence of continued slow payment or nonpayment of subcontractors such that the mortgage security is jeopardized, we will work with the parties to attempt to resolve problems. Subcontractors always have the option of requesting relief from the mortgagee or bonding company.

There are provisions for payment to contractors for building components stored offsite; however, prior approval by the Department is required. The law was changed to permit progress payments to be made for building components stored offsite in recognition of the savings that often result from the timing of the purchase and storage of major building components offsite. Building materials common to the various trades are expected to be stored on-site. Contractors and subcontractors may elect to purchase materials and store them offsite, but HUD will not approve progress payments for such materials until they are brought on-site or actually installed in the project.

We trust that your other concerns were associated with isolated cases. The absence of an employee from a HUD Field Office should not interrupt the flow or progress of the work. HUD's mortgage credit personnel are instructed that tap fees and other fees, when applicable, are approved when actually due and payable and supportable by billings.

I hope this information is satisfactory to you.

Very sincerely yours,

R Hunter Cushing

R. Hunter Cushing
Deputy Assistant Secretary for
Multifamily Housing Programs

Attachment N

GENERAL CONDITIONS

1. DEFINITIONS

a. The "Contract" means the Contract executed by the LHA and the Contractor, of which these General Conditions form a part.

b. The terms "LHA" or "Local Authority" and "Contractor" mean the respective parties to the Contract.

c. The term "HUD" means the United States of America (acting through the Department of Housing and Urban Development) which (subject to the provisions of a contract for financial aid with the LHA) has agreed to purchase certain obligations of the LHA to aid in financing the work to be performed under the Contract. However, nothing contained in the Contract shall be construed to create any contractual relationship between the Contractor and HUD.

d. The term "Project" means the housing project, the construction work for which is contemplated in whole or in part under this Contract.

e. The term "Architect" means the person, firm, or corporation under contract with the LHA for architectural-engineering and other services related to the work as provided for in the Contract.

f. The term "Contracting Officer" means the person within the LHA's organization duly authorized by the governing body thereof to administer construction contracts for, and in the name of, the LHA. It does not necessarily mean the person executing this Contract. The LHA shall advise the Contractor as to the person or official who is designated Contracting Officer.

g. The term "Specifications" means the volume which includes, and the term shall include, the Instructions and Forms (consisting of the Form of Invitation for Bids, Instructions to Bidders, Form of Bid, Form of Bid Bond, Form of Non-Collusive Affidavit, Form of Contract and Form of Performance and Payment Bond or Bonds), the General Specifications (consisting of the General Conditions, the Special Conditions, and the Schedule of Drawings) and the Technical Specifications.

h. The term "Drawings" means the Drawings enumerated in the Schedule of Drawings.

2. CONTRACTOR

a. Except as otherwise specifically stated in the Contract, the Contractor shall provide and pay for all materials, labor, tools, equipment, water, light, heat, power, transportation, superintendence, temporary construction of every nature, taxes legally collectible because of the work, and all other services and facilities of every nature whatsoever necessary to perform the work to be done under the Contract and deliver it complete in every respect within the specified time.

b. The Contractor shall personally supervise the work or have a competent superintendent on the work at all times during progress with full authority to act for the Contractor. The Contractor shall also provide a staff adequate to coordinate and expedite his work and that of his subcontractors to ensure compliance with contract requirements.

c. The Contractor may authorize his superintendent or other individual to sign for him and in his name, if the contractor has filed with the LHA a notarized statement evidencing such authorization and authenticating the signature to be so honored.

d. The Contractor shall lay out the work and be responsible for all lines, levels and measurements of all work executed under the Contract. He shall verify the figures before laying out the work and will be held responsible for any error resulting from his failure to do so.

3. SUBCONTRACTS

a. The Contractor shall not contract with any proposed subcontractor who has not been accepted by the LHA.

b. As soon as practicable prior to the award of each subcontract, the Contractor shall notify the LHA in writing of the name of each subcontractor proposed, and furnish such written information as it may require concerning the proposed subcontractor, together with the proposed subcontractor's non-collusive affidavit in the form prescribed by the LHA. Any objection shall be expressed in writing by the LHA within ten (10) days after receipt.

c. The LHA may, without claim for extra cost by the Contractor, disapprove any subcontractor for cause on the basis of its own determination or because of the fact that the proposed subcontractor is listed as ineligible to receive awards of contracts from the United States on a current list or lists furnished by HUD.

d. The Contractor shall be as fully responsible for the acts and omissions of his subcontractors, and of persons either directly or indirectly employed by them as he is for the acts and omissions of persons directly employed by him.

e. The Contractor shall cause appropriate provisions to be inserted in all subcontracts relative to the work to bind subcontractors to the terms of the General Conditions, Special Conditions, and other documents comprising the Contract in so far as they are applicable to the work of subcontractors. The Contractor shall insert in each of his subcontracts the provisions (appropriately modified) of paragraphs 27, (and with respect to subsection 27f(2), copies of 29 CFR 5a.4, 5a.5, 5a.6 and 5a.7 shall be attached) 29, 30, 31, 32, 33 and 34, of these General Conditions.

f. Nothing contained in the Contract shall create any contractual relation between any subcontractor and the LHA.

4. OTHER CONTRACTS

The LHA may award other contracts for additional work, and the Contractor shall fully cooperate with such other

April 6, 1987

The Honorable John Glenn, Chairman
Committee on Governmental Affairs
ATTN: Chief Clerk
United States Senate
Washington, D.C. 20510-6250

Dear Senator Glenn:

This letter is written in response to questions posed to the Associated Specialty Contractors by Senator James Sasser subsequent to the March 19 hearings on S 328, the "Prompt Payment Act Amendments of 1987". The responses are numbered in the same sequence as they were asked (copy of questions attached).

1.a "Requisite and traditional procedures" as alluded to by the Associated General Contractors might include such management tools as withholding percentage retainages from progress payments, withholding the final payment until completion of the job instead of releasing it when the subcontractor has completed his work and withholding of an amount from the final payment to cover "punch list" items at the job's conclusion.

However, it should be noted that prime contractors, subcontractors and Federal contract construction policy has been evolving in recent years to eliminate these "traditional" practices in favor of those which stimulate increased job productivity. For example, for many years the "tradition" was to withhold 10% from every prime or subcontractor payment as a security. In fact, this did more to enhance the owner's cash flow position than it did to protect him. As interest rates soared in the `70's, the cost of financing the retainage - which is built into the bid price - grew tremendously. As a result levels of retainage dropped. Current retainage practice on private work - where there is a retainage withheld - is to withhold 10% until the job (or individual subcontractor's) work is 50% complete, then to eliminate the retainage. Others might withhold 5% across the board. In either case it constitutes an effective retainage rate of 5%.

The Federal government has instituted a policy of withholding NO retainage on construction work except in cases where its use can be justified by the contracting officer based on job-specific conditions. In both situations - reduction of the "traditional" retainage amount or its elimination entirely except in specific instances - there has been no increase in defects, contractor defaults or other problems. In fact, it has saved the government money because the cost of financing the retained portion of the progress payument has been eliminated.

As a result "traditional" procedures are changing and evolving. What has been the tradition of the past is not inevitably the way of the future. Conditions change, technology changes and management techniques change - in the best interests of the industry and the customer.

By the way, prime contractors currently have the right to require bonds of their subcontractors. However, they do not exercise this right often because it increases subcontractor bid prices. Most prime contractors know their subcontractors. A good prime will not solicit a bid or accept one from a subcontractor who is a completely unknown quantity. If he does so, he has the ability to require sub bonding.

Apparently the AGC believes that "traditional procedures" mean that prime contractors who "traditionally" have violated the terms and conditions of their subcontract payment clause should have the right to continue to do so. We must disagree with the need for this sort of "traditional" behavior.

1.b No normal and legal subcontract administration tools are lost as a result of Section 7 of S 328. A prime contractor who abided by the terms of his subcontracts would never have reason to know the Section even existed. This section ONLY requires the prime contractor to live up to standard terms of payment to subcontractors...in other words, to honor his commitment and obligation. It takes away no other rights or remedies. In the unlikely case that, should they prove necessary, to enforce performance, the prime contractor retains the right to require bonding, to withhold retainages, to withhold punch list amounts and other means of recourse. Of course traditional and usual warranties on materials and workmanship remain as well.

In point of fact, the greatest single means of enforcing performance from subcontractors remains the certification procedure through which he processes subcontractor claims for payment .

1.c Prior to submitting his bid the subcontractor has knowledge only of the bid specifications and such other information as may be proffered by the prime contractor. Usually subcontract language is not submitted until after the prime has been awarded the contract. After award the prime then submits a subcontract agreement to each proposed subcontractor. Only at that point does the subcontractor know the specific terms offered by the prime. Without that knowledge, the subcontractor must base his bid on standard industry practice or specific knowledge he may have of past practice of the prime in question.

Of course, the subcontractor has the right to offer alternate terms if those offered to him are not suitable. However, since the prime contractor has already been awarded the contract the strength of the subcontractor's negotiating position is substantially less than that of the prime.

2.a As note in the answer to question # 1 above, the prime is always free to require such security of his subcontractors as he may deem necessary. The requirement for this surety is included in his invitation to bid.

2.b A requirement for across-the-board bonding would cause two serious problems. First, it would strain sureties' bonding capacity to the maximum. It is possible that it could even exceed the nation's total bonding capacity.

Even if the bonding capacity were available, the additional cost to the owner would be substantial. The cost of all those bonds would be included in the price of the job. The owner is fully protected by the one bond from the prime. The redundant protection of all sub and sub-sub bids would indicate more that the prime contractor was incompetent than that he truly needed such protection. Should special circumstances arise requiring bonding of subs, the prime is free under current practice to require it.

If fact, if all primes TRULY feel the need to require bonds of their subs if they are forced to live up to their contractual commitments, then they are certainly capable of undertaking such a course of action.

3.a Protection is a relative term. There is no absolutely certain assurance that a job or any part of it will go exactly as planned. It would be very difficult for a contractor to be a successful low bidder if he fully protected himself against every possible contingency.

Standard construction practice is an effort to provide protection against those things most likely to go wrong. A warranty provides long-term protection for the general and the owner - both before and after payment. The certification process provides the most immediate and comprehensive protection. Retainages and punch list withholding can provide lesser, intermediate protection in appropriate circumstances.

The case in point, payment according to standard contract terms, was never intended to be invoked as a protection. It is, quite simply, a payment clause. In standard practice there are no caveats that allow breach of that clause as a contingency against possible future deficiencies that will most probably never occur. (To do so would be akin to waiting to pay for a loaf of bread until after it had been eaten and fully digested to see if it might accidentally contain some toxic substance.)

3.b In actual operation there are two kinds of warranties. On electrical and mechanical equipment the contractors pass on to the owner the manufacturers'warranties. Any failure here is pursued directly with the manufacturer.

In the case of installation, there are several different ways to pursue remedies, depending on where one is in the constructrion process.

(1) If the problem is evident during construction, then that portion of the work in question does not get certified for payment until it is satisfactorily completed.

(2) If the problem becomes evident while the reponsible party is still on the job, then a retainage can be withheld until the problem is rectified.

(3) If the problem is discovered after the contractor has completed work but before the job is closed out, then final payment may be withheld until it is corrected. If it is a minor item then most of the final payment may be made, with a holdback in sufficient amount to insure completion.

(4) If the entire job has been closed out, final payments made and the contractors have left the job, then the warranty is invoked. A good contractor will honor the warranty and rectify the problem; in the case of a poor contractor the threat of legal action may be necessary. Most contractors value their reputation and will honor their warranty commitments. Those who do not know that a lawsuit will inevitably cost them more than the work under warranty.

Please note that in none of these instances is the question of a certified payment being withheld ever raised. Payment is made only for work satisfactorily completed. Should some part of that work prove unsatisfactory at a future date, then other remedies exist to rectify the problem. Withholding payment due a subcontractor for certified completed work is not and has never been an appropriate or legal remedy for deficiencies. It is not a course of action allowed in the contract and, in practical fact, it is not used as a remedy for deficiencies by prime contractors.

4.a The testimony from Mr. Emerick was the first time the question of bonding had ever arisen in regard to payment provisions. The series of joint policies and guidelines developed among the Associated Specialty Contractors, the Associated General Contractors and the American Subcontractors Association were the result of literally years and years of negotiation, during which each policy or guideline was subject to intensive review by multitudes of contractors and staff of the various groups.

Despite this intensive scrutiny and review, the question of bonding never arose. Upon review of the minutes of the meetings leading up to the adoption of the policy in question, it appears the subject was never mentioned...by prime or subcontractor. Neither is it implied through any arcane addenda. Apparently it was created out of thin air strictly to embellish the AGC's testimony. Since the prime contractor has the right to require a bond of any sub he chooses, it is also a specious argument.

4.b We do not agree with this assertion (or, perhaps, insertion) regarding the joint policy statement. The policy stands alone as written and agreed to by all parties. There is no basis for the condition placed on the agreement in Mr. Emerick's testimony.

5. Indeed, subcontractors are free to choose those with whom they contract. However, the subcontractor has to be realistic. If their client list is too restrictive, they may soon no longer be subcontractors. Subcontractors who wish to perform government work

are at a particular disadvantage. Since all government jobs are bid work, they have to bid to as many of the primes who are bidding the job as they can. Certainly, they will not bid to those primes whom they know to be outright thieves or incompetents, but if they wish to get the job, they have to bid it to a winner.

The prime contractor on Federal construction is in the drivers seat. He is awarded the contract before his subcontracts are signed. Since he has the contract, he can demand terms of his subs that he couldn't possibly get if he could not dangle the contract in front of them. They know he is in a position to shop their bid to another sub just as soon as they disagree with his terms. There is a major inequity in the positions of the two parties negotiating the terms of the subcontract. The prime holds all the aces.

6.a AGC Form 600 provides only for payment of interest on late or unpaid progress or final payments "*at the rate provided in the Contract Documents.*" Given the prime contractor's superior bargaining power (since he holds the contract), he has the upper hand in setting that rate. Only in the absence of any interest language does the subcontractor receive interest "*at the legal rate prevailing at the place of the Project.*"

This form does NOT assure the same interest as that applicable under the terms of the Prompt Payment Act, nor does it assure any interest in the case where a payment delay is caused by action or inaction of the prime contractor.

Beyond that, the sub has no avenue of recourse for motivating the prime contractor to make payments, with or without interest, other than instituting a work stoppage. Shutting down a job is an expensive and radical step. If carried through it usually will bring about further expenses and delay in the form of litigation.

6.b AGC's Form 600 makes any interest payment to a subcontractor directly contingent upon receipt of the funds from the owner. If fact, there is a presumption in the Final Payment Failure and Late Payment Interest sections of Form 600 that the only late payments for which interest can be assessed are those which are the fault of the owner. Quite obviously the owner is not going to pay interest on a payment he has already made to the prime contractor, but which has not been passed on to the subcontractor. The language of AGC Form 600 states: "*To the extent obtained by the contractor under the contract documents...progress payments or final payment due and unpaid...shall bear interest....*"

7. It is the contention of the Associated Specialty Contractors that the number and variety of the types of requirements which, by law, must now be passed through to the subcontractor is so broad and inclusive that the concept of contract privity in the context of a Federal contract is nonexistent. A large section of our written testimony is devoted to this issue, as is a supplementary statement from the firm of Kasimer and Ittig, specialists in construction law.

Existing flow-down provisions exist because Congress chose to expand public policy through the contracting system. It does not matter what the cause or rationale for the passed-through requirement; the simple fact that the provision is passed through to the subcontractor for the purposes of implementing public policy immediately destroys the concept of contract privity, which rests on its inviolability. Every additional pass-through provision reiterates the fact that Public Policy takes precedence over the traditional concept of contract privity.

Subcontractors hope that, through Section 7, Congress will establish another public policy that says, in effect, that prime contractors on Federal work will no longer be able to exploit their subcontractors for their own enrichment, and that all those working on a Federal construction project deserve fair treatment and prompt payment.

Thank you for allowing us this opportunity to respond to your questions.

Sincerely yours,

Daniel G. Walter. President
Associated Specialty Contractors
for Mr. David Buttrum

QUESTIONS FOR THE RECORD FOR --
MR. DAVID A. BUTTRUM, Representing the
Associated Specialty Contractors

1. A fundamental thrust of AGC's opposition to Section 7 is founded upon the assertion that it places new risks and liabilities on the prime contractor while denying the "traditional private subcontract administration tools." Mr. Emerick, the witness for the Associated General Contractors of America (AGC), emphasized that without subcontractor bonding the prime contractor must retain "all of the requisite and traditional procedures . . . necessarily including terms of payment" to protect itself.

a. What is your understanding of these "requisite and traditional procedures"?

b. What traditional subcontract administration tools are lost under Section 7?

c. Is a prospective subcontractor generally aware of the terms of payment, and any other terms that deviate from industry standard forms, e.g., AGC Form 600 (Subcontract for Building Construction), prior to submitting its bid or only after submission?

2. During his testimony, Mr. Emerick urged that if Section 7 is not deleted, it must be amended to require all subcontractors to post payment and performance bonds. The sponsors of Section 7, as well as its proponents, maintain that the provision leaves totally unimpaired a prime contractor's present discretion to require bonds from its subcontractors, when it makes good business sense.

a. Isn't a prime contractor always free to require performance and payment bonds from its prospective subcontractors?

b. Are any problems likely to result from requiring subcontractor bonding across the board, rather than leaving it to the business judgment of the prime contractor to be exercised on a case-by-case basis?

3. In his testimony, Mr. Emerick presented an example to demonstrate why AGC believes Section 7 exposes prime contractors to unreasonable risks. In that example, a prime contractor's inspection fails to detect a deficiency in a subcontractor's work which is subsequently detected by the Government after the subcontractor has departed the job, having been paid (less any retained amounts) in conformity with Section 7. The Government looks to the prime contractor for corrective action and because the subcontractor was not bonded, Mr. Emerick asserted that the prime contractor is unreasonably exposed.

The AGC Form 600 requires a subcontractor "to warrant its work against all deficiencies and defects in materials and/or workmanship" for the period established in the contract between the owner and the prime contractor (a flow-down provision) or, if there is no such provision in the contract documents, "for the period of one year from the date(s) of substantial completion of all or a designated portion of the Subcontractor's Work, or acceptance or use . . . whichever is sooner."

a. Do such warranty provisions provide adequate protection for the prime contractor in assuring subcontractor performance, both before and after the subcontractor has been paid?

b. How do such provisions operate in actual subcontract arrangements?

4. In developing Section 7, the sponsors were under the firm impression that payment of a subcontractor by the prime contractor within seven days after receipt of the Government's payment by the prime actually reflected the prevailing industry standard and was, therefore, used as the bill's minimum standard for the subcontract payment term. The seven-day standard is reflected in the AGC-ASA-ASC Joint Policy Statement on Prompt Payment, as well as in the AGC Form 600 model subcontract agreement. The AIA's Standard Form of Agreement Between Contractor and Subcontractor (Document A-401) provides for a three-day payment term, which exceeds the Section's prescribed minimum standard. Nowhere within the Joint Policy Statement or the AGC Form 600 is there even an implication that the payment term applies only if the subcontractor is bonded. Yet, during his testimony, Mr. Emerick unequivocally asserted that AGC endorses equal treatment regarding payment between the prime contractor and its subcontractor only when there is "like security," i.e., the same bonding protection that exists between the Government and the prime contractor.

a. Why wasn't this issue addressed, or even implied, in the AGS-ASA-ASC Joint Policy Statement?

b. Do you agree with AGC's assertion?

5. In his testimony to the Committee, Mr. Emerick dismissed any imbalance in the bargaining power between parties to the subcontract agreement. He asserts that subcontractors are "free to pick and choose their projects and the general contractors they work with."

Q. Would you respond to this assertions from the vantage point of the day-to-day business environment faced by subcontractors?

6. AGC argues that Section 7 is unnecessary because it duplicates protections against late payments afforded by various model subcontract agreements, such as the AGC Form 600.

a. Does the AGC Form 600 agreement assure the subcontractor a late payment interest penalty at a rate equal to that applicable between the prime contractor and the Government under the Prompt Payment Act?

b. Doesn't the AGC Form 600 make the subcontractor's entitlement to any late payment interest penalty totally contingent upon the prime contractor being able to pass the cost of the interest penalty on to the Owner, i.e., the Government?

7. Each of the witnesses on your Panel shared with the Committee his views concerning the precedential value of current contract provisions mandated for flow-down between a prime contractor and its subcontractors on federal construction projects. The testimony of AGC's witness and the attachments to its written statement vigorously assert that there is no precedential value. The 18 February 1987 legal memorandum from King and King states: "The only areas in which the Federal Government has injected itself involving subcontractor matters involves socio-economic programs of the Federal Government." In a 13 March 1987 letter to the Chairman of the Committee on Small Business, Hubert Beatty, executive vice president of the Associated General Contractors of America, said: "Each and every flow-down pursues one of another of broad National social, labor, economic, environmental, or fiscal policies . . . ." During his oral testimony, Mr. Emerick stated on several occasions that the various mandated subcontract provision address only "socio-economic, civil rights or environmental matters."

Q. What is your evaluation of the existing flow-down provisions?

PREPARED STATEMENT

OF

JOSEPH R. WRIGHT, JR.

DEPUTY DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

WASHINGTON, D.C.

MARCH 19, 1987

Mr. Chairman and Members of the Committee, it is a pleasure to appear before you today to discuss the timing of Federal payments. It is particularly important to me to talk to a Committee which, along with the House Committee on Government Operations, has taken crucial steps in solving the payment problems which frustrate and handicap government suppliers. I would like to talk about this subject in two contexts.

First, I will give our view of S. 328, the Prompt Payment Act Amendments of 1987. Then I would like to spend a little time on the question of payment processes across government programs.

Like the Prompt Payment Act of 1982, we think that S. 328 seeks to ensure that the Federal Government pays its bills on time or pays an interest penalty, so that vendors doing business with the government are treated fairly. We wholeheartedly endorse this goal. S. 328, in large part, will support and reinforce our efforts to manage the payment process more effectively -- and it is a good business-like way to operate the government.

The Federal Government's annual cash flow of collections and disbursements is approaching two trillion dollars| In 1986, payments covered by the provisions of the Prompt Payment Act were over $164 billion. This administration has made and will continue to make a commitment to implement the best available, cost-effective practices to ensure that our financial responsibilities -- including paying bills on time -- are fulfilled completely. Our goal for the end of 1988 is to eliminate payments made after the due date and payments made too early.

Background of Prompt Payment

Early in this administration we found that 30 percent of the bills paid by Federal agencies were made too late ($24 billion in 1981) and 45 percent were made too early ($35 billion in 1981). OMB immediately issued guidance to the agencies to resolve the problem. Later, using authority provided by the Congress in the Prompt Payment Act, we made streamlining payment practices a top priority of the President's Management Improvement Program: Reform '88. We pushed hard for more timely payment through implementation of our Circular A-125, "Prompt Payment" and by insisting on special reviews of payment systems under the Federal Managers' Financial Integrity Act and Circular A-123, "Internal Control Systems." Our Prompt Payment Task Force and Financial Integrity Task Force followed up consistently and vigorously on implementation.

These efforts have paid off. Reports from the agencies, GAO, and the contracting community in testimony before Congress confirm that improvements have been made resulting in better service to the vendors and increased government savings. As we reported this week in our annual report, the majority of these payments (84 percent -- or $152 billion) were made on time in 1986. About 13.5 percent of the payments were made during the 15 day grace period._ Interest penalties of $7.2 million were paid on only 0.8 percent of all payments. This occurred while total payments were increasing by 22 percent over 1985 to nearly 35 million actions and $164 billion in 1986. While we are proud of the progress to date we are also attentive to recommendations, especially in the 1986 GAO report, about ways fully to achieve the benefits of the Prompt Payment Act.

Remaining Problems

The sponsors of S. 328 and the GAO have pointed out some very real problems with implementation of the Prompt Payment Act:

- Delayed acceptance of goods that prevents the start of the payment clock;
- Intentional abuse of the grace period;
- Payments made after the grace period without the interest penalty;
- Discounts taken after expiration of the discount period;
- Lost or misdirected invoices;
- Inadequate coverage of payment terms in the Federal Acquisition Regulation (FAR); and
- Gaps in agency reporting to OMB on payment practices.

We agree that there are problems in these areas and pledge to correct them in the next two years.

Proposed Solutions

OMB has already taken a number of steps to rectify these problems:

- In June 1986, we issued a proposed revision to circular A-125 that would make several of the changes proposed in S.328.
- The Federal Acquistion Regulatory Council, working closely with the Office of Federal Procurement Policy, issued a proposed addition to the Federal Acquisition Regulation. Significant concerns about this proposal were raised in many quarters; the Council is working to resolve these issues and will shortly issue another proposed rule for comments. The new proposal will conform to the existing Circular A-125 and will address many of the concerns raised by the sponsors of S. 328.
- In November 1986, we revised our reporting instructions to agencies to include data on late payments that did not include interest penalties.
- We also required agencies to report to the President and Congress, under OMB Circular No. A-123, Internal Control Systems, on any deficiencies in their implementation of the prompt payment requirements. For the most part agencies indicated substantial compliance with the act. However,

several agencies reported implementation deficiencies that support the findings in the GAO report.

As I said earlier, we are committed to solving these problems through administrative action and, where appropriate, legislative change. We envision a comprehensive effort to manage the payment process better. We will reach our goal in two ways. First, the necessary policy framework will be completed by:

- Completing revision by April 1987 of Circular A-125 to clarify policies, set more rigorous deadlines, and increase agency accountability;
- Completing revision of the FAR by September 1987 to ensure uniformity of guidance throughout the related procurement and payment processes and to reduce the risk of paying early or late and the corresponding costs to vendors and the government; and
- Working to increase agency incentives to create effective controls over their payment processes by eliminating the grace period.

Concurrently, we are putting in place an aggressive program of monitoring and followup working with the Inspectors General to identify and correct operational problems through:

- Immediate use of agency reports submitted for FY 1986 to identity patterns of early payment, late payment, failure to pay interest penalties when due, and excessive use of the grace period. We will ask the agencies to submit by July 1 corrective action plans to solve specific problems.
- An annual process of validation by the Inspectors General of data reported by the agencies under Circualr A-125 to be completed by October 1;
- Annual Inspector General validation of agency assessments of compliance with the Prompt Payment Act under Circular A-123; and
- Requiring agencies to correct deficiencies by developing automated processes, where they are not already in place, to assure routine compliance.

Another related administration goal is to modernize and upgrade the systems which support a host of financial activities, including the payment process. These improvements will make it feasible for agencies to make use of the best of cost-effective modern technology in ensuring that the Prompt Payment Act requirements are met.

Provisions of S. 328

For the most part we support S.328. OMB Circular A-125 currently includes or will be revised to cover the following provisions of the bill:

- The definition of receipt of invoice;
- Constructive acceptance after five days;
- Automatic payment of interest penalties;
- Payments under construction contracts, partial deliveries and amounts retained until final acceptance of construction;
- Periodic payments under supply and service contracts; and
- Limitation on discount payments.

We strongly support implementation of the Prompt Payment Act through the Federal Acquisition Regulation and have no objection to this provision of the bill. We also support inclusion of the United States Postal Service in the Prompt Payment Act so long as USPS independence is maintained.

But we do not see any reason to require double interest penalties. This provision could increase the incentive for agencies to improperly deny that penalties are due, increase the incidence of contract disputes, and otherwise strain the business relationship between the Government buyer and the commercial vendor. We have the statutory and regulatory basis we need to solve the problem of agency failure to pay interest penalties when due. What is needed now is action to identify the specific agency operating problems and see that they are corrected.

And we oppose the provision which would require a payment clause in construction subcontracts governing promptness of payment and payment of interest penalties. The government should not impose itself in this way in the payment provisions negotiated among private firms. This provision could also lead to extensive litigation in the courts and Boards of Contract Appeal.

We strongly support the proposed additional reporting requirements and have taken steps to collect similar information.

Not only do we support the proposal to phase out the grace period, but we think we can accelerate the process and complete the phase out before the 1990 deadline set in the bill. Agencies reported making 76 percent of their grace period payments in FY 1986 in the first seven days of the period. We believe this record can and will be vastly improved with the added incentive to agencies of a reduced grace period. By 1989, we expect that agencies' accounting and payment systems will have been sufficiently improved to make complete phase out relatively smooth.

Prompt Payment in a Wider Context

Now I want to turn to a related concern having to do with the promptness standards in force in Federal disbursements through purchases and grants-in-aid to State and local governments, not currently covered by the Prompt Payment Act. In 1986, the Federal government spent $223.7 billion to purchase goods and services in both defense and nondefense programs; the Prompt Payment Act covered $164 billion of these expenditures. At the same time, $107.4 billion was spent on grants-in-aid to State and local governments -- not subject to the Act. These programs operate under very different payment schedules, some of which place the government at a disadvantage. We would like to work with you to explore ways in which the fairness principles of the Prompt Payment Act can be extended to all parties.

Conclusion

In conclusion I would say that, while we can solve many of the problems mentioned in this bill through administrative action we particularly welcome the proposal to eliminate the grace period as a way to make the payment system fair to the vendors we serve.

This concludes my statement. I'll take any questions you have.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

STATEMENT OF
HONORABLE FRANK S. SWAIN
CHIEF COUNSEL FOR ADVOCACY
U.S. SMALL BUSINESS ADMINISTRATION
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
OF THE
UNITED STATES SENATE
ON THE
"PROMPT PAYMENT ACT AMENDMENTS OF 1987"
MARCH 19, 1987

Mr. Chairman:

Thank you for this opportunity to present my views on S. 328, the "Prompt Payment Act Amendments of 1987". The purpose of the bill is to strengthen procedures to ensure that the Federal government pays its bills on time, a goal which is wholeheartedly supported by the small business government contractor community. For many small businesses, doing business with the government is often much more difficult than dealing in commercial markets. I have long been concerned by the barriers to entry in the Federal marketplace imposed by the myriad procurement regulations and paperwork requirements. When small businesses successfully surmount these initial barriers, only to find that government offices do not pay for delivered goods and services in a timely manner, their frustration mounts. The intent of S. 328 is simple -- to ensure the Federal government is a reliable business partner.

As you know, the purpose of the Prompt Payment Act of 1982, P.L. 97-177, was to encourage agencies to streamline and expedite their payment processes. The benefits are twofold. First, it serves to make a contractor whole by providing for interest payments on overdue bills. Second, it benefits the government and taxpayers by encouraging agencies to take advantage of prompt payment discounts offered by Federal contractors. That legislation was prompted by numerous complaints, including a 1978 General Accounting Office (GAO) study that found up to 30 percent of the government's bills were being paid late.

Since implementation of the Act, payments to government contractors have improved. However, significant problems persist. These problems were dramatically brought to my attention during the 63 state and regional meetings culminating in the 1986 White House Conference on Small Business. In virtually all of the sessions devoted to government procurement issues, small business contractors recited examples of bills being paid late, invoices being lost, interest not being included in late payments, and early payment discounts being taken long after the discount period had expired. As a result, the 1800 delegates to the White House Conference identified most of the prompt pay reforms contained in S. 328 as top small business legislative priorities. The GAO's August 1986 report on the Prompt Payment Act -- which found that 24 percent of Federal vendor payments in its sample were made after the due date and that 7 percent of the late payments were between 46 and 150 days late -- confirmed the individual experiences recounted by the White House Conference delegates.

THE REFORM PROVISIONS OF S. 328 ARE APPROPRIATE

The proposed Prompt Payment Act amendments would make a number of substantive changes and clarifications to the original Act. These changes address the concerns raised at the White House

Conference and by the GAO. The Administration is aware of these problems, and I am informed that both OMB Circular A-125 and the Federal Acquisition Regulations are being reviewed.

First, the definition of when an agency is deemed to have received an invoice is made more precise so that both the government and its contractors will clearly understand their respective rights and obligations. Under section 3 of the bill, the time for payment will begin to run either on the date that a proper invoice is first received by the agency or five days after the goods are delivered or the services are performed, whichever is later. This provision would eliminate the present open-ended time period associated with the processing and formal "acceptance" of invoices by establishing a five day acceptance standard, and will eliminate any incentive that government payment officers may have to "lose" invoices or delay formal acceptance in order to delay payment.

Second, the present 15 day "grace period" would be phased out and ultimately eliminated for solicitations issued after the beginning of Fiscal Year 1991. This grace period is becoming unnecessary now that agencies are gaining experience with the Act and have begun to streamline and expedite their payment procedures. In the private sector, sellers hold their customers to the payment terms in their contracts -- usually 30 days -- and do not customarily provide interest-free "grace periods." To the extent that the government engages in commerce, there is no reason that it should not also be held to the letter of its contractual commitments.

Third, the bill would clarify the interest payment provisions. Interest on unavoidably late payments should be made automatically and routinely, without requiring contractors to make a specific demand. When a contractor meets the obligations of a contract and submits a proper invoice, timely payment is the law and interest penalties for late payment are a matter of right. Thus, proper implementation of the Prompt Payment Act requires a clear statutory or regulatory mandate for automatic payment of interest.

Fourth, while the Prompt Payment Act was originally intended to apply to periodic payments under supply contracts and retained amounts under construction contracts, some agencies have not so construed the language of the Act. However, it is just as important for these payments to be paid on time as it is for any other payments, and the government should live up to all of the payment terms contained in its contracts. S. 328 would clarify and make explicit that these are also subject to prompt payment procedures.

Finally, the bill would make clear that Federal agencies which are offered discounts for early payment may take those discounts only when payment is actually made during the discount period. During the White House Conference proceedings, I heard from many small business contractors that they have stopped offering early payment discounts because of the government's unfortunate tendency to take those discounts even when the bills are paid late. As the 1986 GAO report pointed out, the taxpayers' interest is best served not only by paying bills on time, but also by taking advantage of legitimate discounts offered by contractors.

In sum, S. 328 addresses these problems remaining after passage of the Prompt Payment Act in a simple and straightforward manner. It has the strong support of the small business community.

REGULATORY IMPLEMENTATION OF PROMPT PAYMENT PROCEDURES IS NECESSARY

As is the case with much Federal legislation, many of the provisions of the Prompt Payment Act are not self executing, but must be supplemented by appropriate guidelines and directives to ensure their successful implementation. In

August, 1982, the Office of Management and Budget issued Circular A-125 to the heads of Federal agencies informing them of the requirements of the Prompt Payment Act. Although payment practices improved following issuance of the Circular, I believe that much of the present confusion as to the proper implementation of the Prompt Payment Act is due to the fact that appropriate solicitation provisions and contract clauses were never incorporated into the Federal Acquisition Regulations (FAR). The FAR is the single comprehensive body of regulations to which both government contracting personnel and Federal contractors routinely refer for guidance. Since most contractors rely primarily on the FAR in their dealings with the government, many were actually unaware of their rights and obligations under the Prompt Payment Act and Circular A-125.

In July, 1986, the Federal Acquisition Regulatory Council issued a proposed rule to include prompt payment procedures and requirements in the FAR. 51 Fed. Reg. 25976 (July 17, 1986). I was particularly disappointed by the proposed regulations, however, because they did not adequately implement the intent of the Prompt Payment Act and the provisions of Circular A-125.

The most significant problem with the FAR proposal involves the requirements for Federal agencies to pay interest. The FAR proposal established criteria for the payment due date which would be inserted in most contracts. The proposed new clause would define the "acceptance date" of goods and services for prompt pay purposes as having "occurred on the 30th day following the date of contractor delivery of supplies or services." After the government has "accepted" the deliverables, it would have up to four more days to submit a "receiving report", which is written evidence of acceptance, to the designated payment office. This four day period would apply "unless other arrangements have been made." This language implies that if agencies need more time to issue receiving reports they may take it.

The problem with these provisions becomes apparent when the payment due dates under Circular A-125 and the FAR proposal are compared. According to Circular A-125, a 30 day period after receipt of a "proper invoice" plus a 15 day "grace period" -- a total of 45 days -- is allowed before interest penalties must be paid. This comports with the requirements of Section 2 of the current language in the Prompt Payment Act. The FAR proposal, on the other hand, would allow 30 days for acceptance of the goods or services, an additional four days for submission of a receiving report, 30 more days to pay after the receiving report is received, plus an additional 15 day grace period. This totals a minimum of 79 days before interest penalties would begin to accrue. The FAR proposal would therefore almost double the existing time allowed for the government to pay its contractors before interest penalties are triggered. This is clearly not a proper regulatory implementation of the Prompt Payment Act.

I was also disappointed that the FAR Council failed to take the opportunity to make other appropriate regulatory changes in existing payment practices, such as clarifying that progress payments and retained amounts under construction contracts are subject to prompt payment procedures. A copy of my formal comments to the FAR Council on these issues is attached.

In light of the problems experienced in implementing prompt payment procedures during the last five years, the provisions of S. 328 directing the amendment of the FAR to include provisions for payment terms, and specifying how those provisions should read, are appropriate. The inclusion of clearly defined payment dates in all Federal procurement contracts is absolutely critical to the success of any effort to secure prompt payment.

Once again, Mr. Chairman, I appreciate your holding these hearings today. Your Committee is exploring an area of critical concern to the small business community. The Office of Management and Budget has advised that there is no objection to the submission of these views to the Congress from the standpoint of the Administration's program. I will be happy to answer any questions you have.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

September 15, 1986

Ms. Margaret Willis
FAR Secretariat (VRS)
General Services Administration
18th and F Streets, N. W.
Room 4041
Washington, D. C. 20405

Re: FAR Case 84-30

Dear Ms. Willis:

These are the comments of the Office of the Chief Counsel for Advocacy, U. S. Small Business Administration, regarding FAR Case 84-30, the proposed Federal Acquisition Regulation (FAR) implementation of the Prompt Payment Act (P. L. 97-177), and Office of Management and Budget (OMB) Circular A-125, "Prompt Payment." The proposed language differs from the OMB Circular in a way that is not beneficial to small business, allowing additional time for an agency to delay payment. We suggest that the proposal be rewritten to conform to OMB Circular A-125, and that notice of proposed rulemaking be published to solicit public comments on the revised proposal.

As you are aware, specific legislation, P. L. 94-305, 15 U.S.C. 634c, authorizes the SBA Office of Advocacy to represent the views and interests of small business before Congress and Federal agencies when their policies, regulations, or other actions would affect the small business community. In addition, this office is responsible for monitoring Federal agencies' compliance with the Regulatory Flexibility Act (RFA) P. L. 96-354, 5 U.S.C. Section 601 et seq. My comments are submitted pursuant to this authority.

I. FAR CASE 84-30 DEVIATES IN SIGNIFICANT WAYS FROM OMB CIRCULAR A-125

FAR Case 84-30 would implement OMB Circular A-125 in the FAR by adding a new FAR Subpart 32.9 and FAR standard clause 52.232-25. However, the FAR proposal in fact, differs from OMB Circular A-125 in several important respects. The most significant differences occur in the sections where the requirements for Federal contracting agencies to pay interest penalties are triggered. For example, the FAR proposal establishes criteria for the payment due date which would be inserted in all contracts except certain contracts for utilities. The proposed new clause defines "acceptance date" of goods and services for prompt pay purposes as having "occurred on the 30th day following the date of contractor delivery of supplies or services" (FAR 52.232-25(c)(4)). After the government has "accepted" the deliverables, it has up to four more days to submit a receiving report, which is written evidence of acceptance by the appropriate Government official (FAR 32.905(c)). This four day time limit applies "unless other arrangements have been made." This language implies that if agencies need more time to issue receiving reports, they may provide it.

The significance of these changes is clearly demonstrated when the payment due dates according to OMB Circular A-125 and FAR Case 84-30 are compared. According to OMB Circular A-125, a 30 day period after receipt of a "proper invoice" plus a 15 day grace period, a total of 45 days, is allowed before interest penalties must be paid. Proposed FAR Subpart 32.9, and standard clause 52.232-25, on the other hand, allow 30 days for the government to accept the provided goods or services, up to four days, even more, if necessary, for the government to issue the receiving report acknowledging acceptance, 30 more days to pay after acceptance (FAR 32.906(a)), and an additional 15 day grace period (FAR 52.232-25(c)(5)), totaling as many as 79 days before the interest penalties accrue. The FAR proposal would therefore almost double the existing time allowed for the government to pay its contractors before interest penalties are triggered. The extra time period poses a hardship on small businesses which complain that the 45 days allowed under OMB Circular A-125 is already too long.

II. FAR CASE 84-30 APPEARS TO CONTRADICT THE LORDAN MEMORANDUM ON PROMPT PAYMENT

On July 18, 1986, Mr. John J. Lordan, Deputy Associate Administrator of the Financial Management Division at OMB issued a memorandum proposing changes to OMB Circular A-125, to the President's Council on Management Improvement. The memorandum referenced OMB Director James Miller's promise to the Senate Small Business Committee to revise the Circular in response to problems identified by the Committee. Primarily, the revision would:

- redefine "receipt to invoice" to start the clock for calculating the payment due date five days after delivery of the product or service;

- clarify applicability of the interest penalty provisions of the act to progress payments and retain amounts under construction contracts; and
- extend agency reporting requirements to include information on invoices paid after the required payment date without the interest penalty.

The Lordan memorandum specifically defines (at Section 4. Part j) receipt of invoice as the later of:

- The date a proper invoice is actually received in the designated payment office; or
- The date on which the agency accepts the property or service. Ordinarily, this shall be no more than five working days following delivery.

Provisions in FAR Case 84-30 contradict this memorandum by establishing as many as 30 days for acceptance of the deliverables.

It must also be noted that proposed FAR Subpart 32.907(g), states that interest penalties are not to be paid to a contractor as a result of delayed contract financing payments, which includes operating capital such as progress payments, advance payments, and interim cost reimbursement. This differs from the Lordan memorandum which states that the proposed revision to OMB Circular A-125 would "clarify applicability of the interest penalty provisions of the act to progress payments and retain amounts under construction contracts."

III. PROPOSED FAR CLAUSE 52.232-5 APPEARS TO VIOLATE THE PAPERWORK REDUCTION ACT

Proposed FAR clause 52.232-25 includes new standards for invoice requirements, including the requirement that the "invoice shall be prepared and submitted to the designated payment office in quadruplicate." This requirement for submission in quadruplicate appears to be in violation of 5 C.F.R. 1320.6, OMB's ""General information collection guidelines." Section 1320.6(c) states that OMB will not approve a collection of information requiring respondents to submit more than an original and two copies of any document, "unless the agency is able to demonstrate that such collection of information is necessary to satisfy statutory requirements or other substantial need." We are not aware of any statutory requirement or existing FAR clause requiring submission of invoices in quadruplicate. We also see no substantial need for any more than the original plus two copies allowed under Section 1320.6. For these reasons, we would recommend that contractors be required to submit only three copies of the invoice in order to be deemed to have submitted a ""proper invoice."

IV. FAR CASE 84-30 DOES NOT COMPLY WITH THE REQUIREMENTS OF THE REGULATORY FLEXIBILITY ACT

The Regulatory Flexibility Act requires agencies to analyze the impact of their proposed rules on small business except when they certify that the rule if promulgated, will not have a "significant economic impact on a substantial number of small entities." Where the impact is not significant an agency may so certify, and a regulatory flexibility analysis need not be performed (5 U.S.C. Sections 603, 605). In this case, the rule was certified as having no impact. For the reasons outlined in the previous two sections, the Office of Advocacy does not agree. We have shown how the proposed FAR Case deviates significantly, and in a way adverse to small businesses, from OMB Circular A-125 as it presently exists, and even more significantly from the proposed revisions. Therefore, it is incumbent upon the two councils to conduct an initial regulatory flexibility analysis, assessing the effect of the proposed rule on affected small businesses.

Of immediate concern to small businesses is that the extra time which may lapse under FAR Case 84-30 before interest penalties are triggered will cost them money. At a minimum, the initial regulatory flexibility analysis should estimate how much this would be. A good starting point for this estimate would be Deputy Secretary of Defense William H. Taft IV's August 7, 1986 statement before the Defense Subcommittee of the Senate Committee on Appropriations. Testifying in connection with defense outlays, Secretary Taft noted on page 4:

> We are reviewing the flexibilities available to us under the Prompt Payment Act. I find, to my surprise, that we are paying bills too early. Our current operating procedures will therefore be amended to issue checks four days later than is present practice consistent with current law. To do so could reduce outlays by as much as $1.2 billion in FY 1987. If we continue this practice, there will be no adverse effect on future years. Further, the Prompt Payment Act provides a 15 day grace period after the payment due date before incurring interest penalties. Delaying payments 10 days into this grace period will reduce outlays by an additional $2.8 billion in FY 1987.

If a delay of 14 days would save the DOD $4 billion dollars, it is not hard to estimate how much the DOD would save by delaying payment from 45 to 79 days. Of this amount, the small business share could be estimated, based on their percentage of DOD contract dollars. Any savings for DOD would of course, represent a cost to the affected small businesses, as they would have to incur the expense of waiting longer to be paid. Although this method would provide only estimated costs to small DOD contractors, because DOD represents between 70-85 percent of procurement dollars for small government contractors, this would be better than no estimate at all.

V. CONCLUSION

For all of the reasons detailed above, FAR Case 84-30 is not a faithful implementation of OMB Circular A-125 and differs significantly from the Circular's provisions. I would strongly recommend that FAR Case 84-30 be rewritten to conform to the Circular's standard of 30 days after receipt of a proper invoice plus 15 grace days before interest penalties are triggered. Because the proposed rule would allow extra days to lapse before interest penalties are triggered, the rule would have a "significant economic impact on a substantial number of small entities." I therefore look forward to reviewing the initial regulatory flexibility analysis for FAR Case 84-30, and expect to pay close attention to the analysis of less restrictive alternatives on small business.

Thank you for the opportunity to comment on a rule of extreme importance to the small business government contracting community. If there are any questions or comments regarding these comments, please feel free to contact me.

Yours very truly,

Frank S. Swain
Chief Counsel for Advocacy

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

May 18 1987

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Senate Russell Office Building
Room 298
Washington, D. C. 20510

Re: S. 328, the "Prompt Payment Act Amendments of 1987"

Dear Mr. Chairman:

I would like to take this opportunity to expand upon my testimony of March 19, 1987, regarding Section 7 of S.328 which would require Federal prime construction contractors to include a prompt payment clause in all construction subcontracts. As you know, some of the witnesses at that hearing expressed concern that Section 7 as introduced could unnecessarily embroil the government in purely private disputes between prime and subcontractors, and could impair the rights of the parties to negotiate retainage terms to assure prompt resolution of performance problems.

I have reviewed Senator Sasser's proposed substitute amendment to S.328, and believe that these concerns have been addressed in that amendment. Section 7(b) of the substitute specifically permits the parties to negotiate and include in subcontracts a term which permits the prime contractor to make a determination to withhold for good cause all or part of a subcontractor's request for payment. Also, Section 7(d) makes clear that any dispute between a prime contractor and a subcontractor as to payment does not constitute a dispute to which the United States may be a party. Thus, the rights and obligations of all parties are clarified.

In my view, Senator Sasser's proposed substitute accurately reflects and incorporates the recommendation of the 1986 White House Conference on Small Business to strengthen the prompt payment law. It should eliminate the remaining prompt payment problems and encourage greater small business participation in the procurement process. S.328 has my wholehearted support.

Thank you again for the opportunity to express my views on this important small business legislation. These are my views as Chief Counsel for Advocacy, and I am not formally speaking for the Administration.

Yours very truly,

Frank S. Swain

Frank S. Swain
Chief Counsel for Advocacy

American Consulting Engineers Council

1015 Fifteenth Street, N.W., Washington, D.C. 20005
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File No. 707.10
700.14

March 17, 1987

The Honorable John Glenn
United States Senate
Chairman, Committee on Governmental Affairs
340 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Glenn:

On behalf of the American Consulting Engineers Council (ACEC), I would like to formally submit for the record our statement in support of the Prompt Payment Act Amendments of 1987 (S.328).

ACEC is an association representing some 4,600 private practice consulting engineer firms with approximately 130,000 employees. These professionals are responsible for the design of billions of dollars in public projects. The vast majority of our member firms are small business entities with limited resources and tight cash flows.

While the Prompt Payment Act (P.L. 97-177) has substantially improved the federal government's billings and payment practices, there still remain ambiguities and loopholes that need to be addressed, as described in the August 1986 General Accounting Office Report (GAO/AFMD-86-69).

The enactment of S.328 will go a long way in eliminating the problems that persist under the current law. In particular, clarification of the dates upon which payment deadlines are established, elimination of the government's grace period, and strengthening requirements for the automatic payment of interest--are all extremely important elements in this bill.

Based upon the strong record created in the 99th Congress and the hearing before your Committee, ACEC urges you to support the bill and to hold prompt markup sessions. With your leadership, S.328 will play an important role in assuring fair and equitable treatment for private sector firms contra[illegible] with the federal government.

Thank you for considering our position on this matter.

Sincerely,

Lester H. Poggemeyer
President

cc: Senator Sasser
Senator Trible

"Serving the Business and Professional Interests of American Consulting Engineers Worldwide"

REBUILDING AMERICA

ACEC'S

1987

Legislative Program

March 1987

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Contact: Mark Casso

PROMPT PAYMENT

Background:

On October 15, 1986, the U.S. Senate passed the "Prompt Payments Amendment of 1986" (S.2479). Because the bill was adopted so late in the session, the U.S. House of Representatives was unable to consider the measure before adjourning. Consequently, a similar bill is expected to be reintroduced when Congress convenes in January, 1987.

The amendment package adopted by the Senate was the first major rewrite of the Prompt Payment Act of 1982 (P.L. 97-177). While there is no dispute that the original act has substantially improved the federal government's billings and payments practices, there still remains a number of problems with the system which the Senate bill addresses. For example, the bill: eliminates the government's 15-day grace period beyond its normal 30-day payment period; strengthens requirements for the payment of interest on late payments; clarifies dates upon which payment deadlines are to commence; and provides a seven-day period for subcontractor payments from prime contractors.

Engineers' Position:

ACEC strongly supported adoption of the prompt payment amendments during the 99th Congress. ACEC urges reintroduction and passage of S.2479 in the 100th Congress.

Status:

Senators Sasser and Trible introduced the Prompt Payment Act Amendments of 1987 (S. 328) in order to eliminate the ambiguities and loopholes in the present law. The bill is virtually identical to the 1986 bill (S. 2479) which passed the Senate in October, 1986.

Hearings are scheduled for the new bill before the Senate Governmental Affairs Committee in early March, 1987.

AMERICAN INSTITUTE OF STEEL CONSTRUCTION, INC.
1629 K Street Northwest ■ Suite 400 ■ Washington DC 20006-1685 ■ Telephone (202) 466-5548

STATEMENT FOR THE RECORD OF THE
AMERICAN INSTITUTE OF STEEL CONSTRUCTION, INC.
REGARDING
PROMPT PAYMENT ON FEDERAL CONSTRUCTION
ASPECTS OF THE
PROMPT PAYMENT ACT AMENDMENTS OF 1987

Submitted to the
Senate Committee on Governmental Affairs

Mr. William Y. Epling
Vice President, Government Affairs
American Institute of
Steel Construction, Inc.
1629 K Street, N.W.
Suite 400
Washington, D.C. 20006

March 23, 1987

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THE AMERICAN INSTITUTE OF STEEL CONSTRUCTION

The American Institute of Steel Construction (AISC) is pleased to submit this statement for the record in connection with the hearings on the Prompt Payment Act Amendments of 1987 regarding prompt payment on federal construction.

The statement provides background information on the AISC and the U.S. fabricated structural steel industry. Our statement then discusses the critical need for prompt payment to be extended to subcontractors on federal construction. Extension is required for basic fair play and, significantly, because it is in the net economic interest of the federal government.

I. General Background

A. The American Institute of Steel Construction (AISC)

AISC, headquartered in Chicago, is a unique voluntary trade association uniting the fabricators of steel framed buildings, bridges and related structures. AISC also serves the erectors, designers and educators who have professional interest in fabricated structural steel structures. AISC has three types of membership: Active, Associate, and Professional.

Active membership is open to companies that fabricate structural steel. Only firms headquartered in the U.S. are eligible. Active membership now totals 380 firms.

Associate membership is open to firms or individuals who sell a product or service related to steel construction (e.g., mill steel producers, steel deck manufacturers, bolt manufacturers, etc.). Associate membership now totals 112.

Professional membership includes firms or individuals practicing as architects or engineers, or teaching either of these professions in a recognized college or university. Professional membership now totals 2,040.

In the early years of steel-framed construction, the growth of our industry was limited by the lack of standard design principles and descriptive product terminology. Producing mills each rolled different sections or shapes and each mill had its own weight load tables and product specifications. In many cases these were inconsistent with the standards of other mills. This condition had existed for many years and was the fundamental reason the AISC was formed in 1921. The original objectives for the AISC were thus:

1. to establish a single standard construction manual recognized by building authorities and designers;
2. to establish a set of standard loading tables for all the sections rolled by the various mills; and
3. the establishment of an authority to foster the efficient use of steel that would be welcomed by the mills, engineering profession, architects, building officials and purchasers of steel.

AISC believes it has accomplished those objectives with distinction.

During recent years AISC's traditional strong emphasis on research and engineering has been expanded to encompass a wide range of educational, market research, and producer certification programs. AISC and its affiliated marketing company have a full time staff of over 50 people and operate under an annual budget of $4 million.

Through its 66 year history, AISC has been highly engineering oriented with a strong emphasis on steel research and steel design techniques. It publishes many technical publications including the "bible" of the industry - the AISC Manual of Steel Construction - which contains the well known AISC Code of Standard Practice for Steel Buildings and Bridges and the AISC Specifications for the Design, Fabrication and Erection of Structural Steel for Buildings. These documents are the basis for most steel bridge and building designs and construction contracts in this country as well as in many other parts of the world.

In April 1983, AISC established a full time office in Washington, D.C. to pursue the fabricated structural steel industry's interests before the Congress, the various federal agencies and with related or allied trade associations.

B. The U.S. Fabricated Structural Steel Industry

The fabricated structural steel industry manufactures custom products for the construction industry. The principal products are steel building frames, bridges and related structures. The leading alternative construction material for these applications is reinforced concrete, which is also widely used throughout the United States. The choice between steel and concrete reflects to a large degree the particular engineering features of each structure, but price is also a major determining factor.

The structural steel fabricator plays a clearly defined and critically essential role in constructing a building or bridge. The fabricator works with the plans and specifications for the structure prepared by architects and engineers to determine the number and type of fabricated steel pieces that will be needed. Using steel shapes and plates purchased from the mill steel producers or steel service centers, the fabricator creates each of the required framing pieces. These fabricated structural steel parts are then properly grouped and transported to the construction site, where the building frame or bridge is assembled by an erecting company or the in-house erecting forces of the fabricator. Typically the fabricator is a subcontractor to the general contractor for the building or bridge.

The U.S. fabricated structural steel industry consists of approximately 1,100 firms, which are typically closely held family businesses. We estimate that the industry now employs approximately 53,000 persons, primarily ironworkers who fabricate steel in our plants. In this sense fabricate means cut, bend, drill or punch, weld or bolt pieces of steel. These ironworkers are supported by estimators, draftsmen, and management personnel.

An industry employing 53,000 persons among 1,100 firms is an industry whose firms average 48 employees. Thus, the U.S. fabricated structural steel industry is a large group of small businesses.

Steel fabricating firms are independent from the mill steel producers, which themselves generally do not engage in the fabricated structural steel business. Mill steel producers such as the Bethlehem Steel Corporation played a major role in steel fabrication until about 12 years ago but they have now largely left our business. It is widely believed that the mills withdrew from fabricating because their labor structures rendered them noncompetitive.

Bureau of Labor Statistics data show that employees of the fabricated structural steel industry earn a wage that is about two percent higher than the average industrial wage. About half of our workers are unionized.

Although the U.S. fabricated structural steel industry is separate from the mill or basic steel industry, the economies of the two are closely linked. The fabricated structural steel industry uses over five million tons of mill steel per year. As such it is a very important customer of the mill steel industry. Our total business volume is over $6 billion per year.

Approximately 55% of the cost of fabricated structural steel products is the price paid for mill steel. Thus, design economy in the amount of steel used and the unit cost of the mill steel affect our competitiveness with foreign fabricated structural steel and with concrete and other materials suitable for building and bridge construction.

The domestic fabricated structural steel industry presently is only marginally profitable. This reflects injury caused by foreign fabricators, including both actual lost contracts and suppression in the price of contracts secured by domestic firms. These effects are greatest in certain regions of the country, particularly the West Coast and the Northeast. Factors contributing to import pressure include the cost advantage enjoyed by foreign fabricators in the price of basic steel and the strength of the U.S. dollar.

Another factor affecting current profitability is the recession of 1982 which caused an overall reduction in the demand for fabricated structural steel products. Heavy construction is generally the last construction sector to rebound in a recovery but in this sustained recovery has yet to be restored. This is generally attributed to the surge in imports that are meeting demand without the normal growth in domestic production facilities. AISC estimates that total employment in the fabricated structural steel industry has fallen over 20,000 during the last six years and that we have experienced approximately 150 plant closings.

II. Prompt Payment on Federal Construction

A. 1982 Prompt Payment Act (P.L. 97-177)

This act requires federal agencies to pay their bills within 45 days or pay interest penalties from the 30th day. While the act has been reasonably effective in getting prompt payment for prime or general contractors (those with direct contracts with teh government) it has not led to similar prompt payment for subcontractors.

B. Payment Problems Facing Fabricators as Subcontractors

Fabricators of structural steel are particularly vulnerable to late or deferred progress payment since the steel frame for a building is among the earliest starting and finishing components of a buidling. Thus fabricators invest in their supplies, principally mill steel, and their shop and field labor early in the project. Because of the inherent high quality control involved in steel from its original mill production, shop fabrication and demonstrable erection in compliance with the plans and specifications, it is readily accepted when in place by the general contractor and/or the owner as fully complying with the contract. It is thus critical that the fabricator be promptly paid and not have to wait on completion of any particular phase or the entire project which may be anywhere from a few months to well over a year after the fabrication and erection is done. It should be noted that the typical fabricator is a small business employing some 48 workers. Clearly such small businesses are critically dependent on a sound cash flow.

With assurance of prompt payment fabricators will be able to eliminate that portion of their costs associated with the risk of late payment. This costs savings will naturally flow from the subcontract to the prime contract to the federal government. Thus, assured prompt payment is in the net economic interest of the government. This economic interest is over and above the federal government's interest in fair play to subcontractors who are largely small businesses.

C. **Prompt Payment Act Amendments of 1987 (S.328)**

S.328, the Prompt Payment Act Amendments of 1987, contains a provision that guarantees the protections of the 1982 Prompt Payment Act to subcontractors on federal construction projects by establishing minimum standards for the payment provision between the prime contractor and its subcontractors.

Section 7, "Payment Clause for Subcontracts Under Construction Contracts," requires a prime contractor on a federal construction project to include a payment clause that reflects "prevailing industry standards" in its subcontracts. "Prevailing industry standards" currently is deemed to be seven days after the prime contractor is paid by the government. If the prime contractor does not pay on time, the subcontractor would be entitled to a late payment interest penalty at the same rate applicable between the prime contractor and the government.

Section 7 of S.328 was drafted specifically to recognize and preserve the principle of privity of contract between a prime contractor and its subcontractors. It merely recognizes that an adequate payment clause is an essential element of a complete subcontract and will go a long way to avoiding prime contractor - subcontractor disputes relating to contract payments. Except for the minimum standards described above, the parties to the subcontract are completely unfettered to negotiate the other terms of their payment clause.

Conclusion

For reasons of simple equity and in the overall net economic interests of the federal government, AISC strongly urges that the prompt payment provision of the 1982 Prompt Payment Act be extended to subcontractors as provided for in Section 7 of the Prompt Payment Act Amendments of 1987 (S.328).

STATEMENT OF THE AMERICAN LOGISTICS ASSOCIATION

Mr. Chairman:

The American Logistics Association (ALA) is a voluntary, nonprofit trade organization whose membership comprises a broad range of grocery, household product, and consumer goods manufacturers, their representatives, distributors, and other suppliers of products and services to the government, primarily for resale in military and civil agency commissaries, exchanges and their 19 related businesses, clubs and hospitality facilities, and for troop feeding and institutional subsistence programs. Attached is a list of the ALA's current corporate members.

We appreciate this opportunity to present our collective members' views on prompt payment generally and the need to strengthen the Prompt Payment Act of 1982 in particular. The ALA was a key participant in the cooperative efforts that brought successful passage of the 1982 Act, and will continue to support efforts, legislative or administrative, that result in prompt payment on the terms of the invoice and or payment of interest penalties for late payments by the federal government.

ALA members are unanimous in their support of the bill introduced by Senator Sasser and Senator Trible on January 20, 1987 -- S.328 -- and are encouraged by the fact that the bill has the support of 74 co-sponsors.

ALA's members provide goods and services to a very unique government marketplace for a very unique customer. The end-users of products manufactured and distributed by ALA members are not airwings, mechanized battalions, light infantry divisions, or naval weapons stations. They are _individual_ active duty service members, their dependents, military retirees, and other authorized patrons who take advantage of their _individual_ military benefit by shopping in _their_ base or post exchange, commissary store, and other resale outlets. This end-user -- the _individual_ patron -- drives this industry's engine of competition because nowhere else in government is there an opportunity for the individual to make product selections based on preference rather than specification.

Despite the burdensome limitations and onerous restrictions imposed on them, these government resale agencies operate within the government structure as a curious anomaly: casual observers are struck by their similarity to civilian grocery and department store retail enterprises.

Of particular note with regard to the issue of prompt pay is the fact that these resale enterprises -- that is, commissaries and exchanges combined -- in fiscal year 1986 generated sales of some $11.7 billion, serving approximately 10.6 million authorized patrons.

The ALA recently conducted an informal survey that will shed some light on the extent to which slow payment problems persist for government suppliers, despite passage of the 1982 Prompt Payment Act.

Our findings, when compared to data collected from an identical 1980 survey--two years before Congress passed the Prompt Payment Act--indicate that not only has there has been little if any improvement in the government's bill paying performance over the last five years, but has actually worsened. The survey and analysis serves the industry as a benchmark against which future progress may be measured. Copies of the survey summary, table of key highlights, survey questionnaire, and tabulations are attached.

Ironically, it seems that the chief payment problems of 1980, afterwards largely addressed by the 1982 Act, have in turn created new or subtly different problems either unforseen or not addressed in the Act. Some of ALA's largest dollar-volume supplier members are reporting that their 1986 military/government accounts receivable records do not reveal significantly improved government bill paying practices since 1980. However, they also reported that the causes for most problems encountered in 1986 were not necessarily the same as those so regularly encountered in 1980.

TOO MANY LOOPHOLES

One major reason why ALA members are seeing many of the same predictable payment problems, only now caused for different reasons, can be traced to ambiguities and other technical weaknesses in the 1982 Act. These ambiguities and deefects furnish hundreds of military and government finance and accounting/payment offices convenient loopholes that are fiscally attractive and routinely exploited to circumvent the Act's intent.

In addition, several of the Act's key provisions are routinely ignored or are simply left hidebound in the limitless paper trails of bureacracy, personnel and resource shortages, incompetency, or a combination of any of these causes.

A recent example of bureaucracy at its worst is illustrated in a "Letter to all Vendors of U.S. Government" from the accounting and finance office at Dyess AFB, TX. The letter states that the Dyess payment office "cannot mail remittance checks to [vendors] without the correct nine digit zip code number" provided in all future "Remit to:" addresses on invoices. The payment center cites "new postal requirements effective 1 October 1986" as its authority for this administrative change. However, ALA research and discussions with Post Office authorities determined that no such requirement exists!

It is incomprehensible that vendors' accounts receivable and credit departments should receive a letter from an obscure government finance office citing an even more obscure regulation to inasmuch say, "No nine-digit zip code, no guarantee of timely invoice payments." This variety of bureacratic nonsense sends a strong negative message to current and potential commissary suppliers, which in turn creates enormous problems for the agency responsible for operating the commissary and providing to its patrons the preferred brand name products--not black and white label made-to-specification provisions--found in modern supermarkets and grocery stores.

It would take only a handful of major national grocery product manufacturers to decide to cancel their scheduled deliveries until timely payment, on the terms of the contract, is restored--or a decision on their part to withdraw from the military/government market altogether--to at once alienate servicemembers from "their store" and exacerbate the existing problems facing individual commissary store managers and their parent agencies.

HOW THE ACT CAN BE STRENGTHENED

The American Logistics Association fully supports S. 328 because it is clear that a legislative remedy is the only possible way to solve persistent government payment policy failures. The Office of Management and Budget to date has not demonstrated that it intends to take meaningful, decisive, and lasting action. If the government's payment policy embarrassments cannot be solved administratively, then S. 328 is the second best and most attractive alternative. The ALA is a member of the Coalition for Prompt Pay and will continue to work through that organization to prompt the soonest possible action in the House of Representatives that will result in introduction of a House companion bill to S. 328.

WHY THE PROMPT PAYMENT ACT MUST BE AMENDED

The need for remedial statutory legislation as opposed to corrective administrative regulation was convincingly presented at hearings held last year to consider S. 2479. The Office of Management and Budget needs a stronger tool that can be used to standardize government-wide efficiency and application of the

1982 Act and OMB Circular A-125.

THE FOCUS FOR REMEDIAL LEGISLATION

There are several ways in which the Act can be strengthened to correct exisiting problems, and they are addressed in S. 328. The ALA believes the keys to a solution reside in payment accountability and responsibility. The following is an outline of some existing problems and their proposed solutions.

1. Receiving Delays

Although the Prompt Payment Act and OMB Circular A-125 are clear about when an agency is deemed to have received an invoice, many agencies can consume many weeks or even months of valuable time certifying, accepting and receiving goods and invoices before forwarding them to an accounting and finance office for payment.

Moreover, it is not uncommon for an agency to purposely delay payment for an unreasonable amount of time until the supplier submits or resubmits a "proper" invoice. These delays are financially harmful to small and large suppliers alike.

The reason why payment delays are so overwhelmingly successful is because the 30-day clock does not move until a "proper" invoice is received.

The solution to this problem, as proposed by the amendments in S. 328, is to provide that an agency is deemed to receive an invoice on the later of:

(A) the date on which the office or employee of the agency designated by the agency to first receive such invoice actually receives a proper invoice, or

(B) on the fifth day after the date on which property is actually delivered or final performance of service is actually completed unless the contract specifies a longer period.

Such a provision would establish a specific requirement that will be less subject to creative misinterpretation.

By establishing in the statute a new 5-day standard for receipt of invoice, setting a federal-wide standard to start the 30-day clock, agencies will be forced to pay according to the rule rather than the exception.

The ALA believes it is possible for government agencies to move receiving and acceptance documents to the payment office within 5 days. This would require the government's receiving sites to use electronic approvals, to effect rapid return of all paperwork, or to specify in the contract that the government cannot meet the 5-day standard.

To prevent the potential for abuse of the 5-day standard (whereby agencies publish and impose commonplace contractual terms stating a mandatory receiving period in excess of the 5 days), any contract adjusted so that the receiving period extends beyond 5 days should have the excess time taken out of the 30-day requirement, with adjustments made so that the 30-day requirement is still met. This approach has been adopted by several states as a workable means to divide the total payment period into separate periods for the two separate functions of receiving and payment.

An alternative approach would be to give agencies the flexibility to set their own standards for internal procedures for receiving, acceptance, and certification--provided that the payment is made within the 30 days.

This alternative would give individual agencies the discreation to decide how much of the 30-day period should be consumed by each function: receiving, acceptance, certification, and issuance of the payment check.

An annual report published by OMB in compliance with the Prompt Payment Act measures only the amount of time consumed by the finance office in processing payments. Therefore it is not a true reflection of actual late pay practices. The Act should be amended to provide for OMB to collect and report to Congress data on the period beginning immediately after physical receipt of invoice. This would give agencies an additional incentive to improve their performance in receiving, acceptance and certification.

2. Abuses Of Grace Period

One of the most disturbing of all abusive prompt payment practices concerns the "temporary" 15-day grace period written into the Act. Many agencies routinely use the 15-day provision to extend payment terms and in effect pursue a 45-day goal rather than the original 30-day goal set by Congress.

The ALA believes the amendment proposed by S. 328 would prevent further abuses of the 30-day goal. The bill provides for a gradual phaseout of the grace period by reducing it to 7 days through October 1, 1990, before finally eliminating it altogether thereafter.

It is not surprising that the 15-day grace period was added to the House version of the 1982 Act at the request of the Defense Department. Our members report that the military departments and agencies routinely pay their bills in 45 or more days rather than 30 days. This practice is clearly at odds with the goal in the House Committee report that stated: "The intent of the Committee that agencies pay their bills by the required payment date is in no way diminished by inclusion of provisions authorizing grace periods."

The majority of ALA members are nationally known manufacturers of semiperishable and perishable food and grocery products. Their goods have a relatively short shelf life. The fact that their commercial customers pay in under 20 days, oftentimes within

10 days, whereas government and military agencies stretch out payments to 45 or more days, is at the crux of their complaint.

It also is worth noting that, in the commercial marketplace, the 30 days that follow after receipt of an invoice is considered the "grace period." Most businesses are therefore unable to rationalize what is represented by the 15-day period other that a "unique privilege of government" and unfair treatment of government suppliers. It is imperative that the grace period be removed so that government will at last stand on an equal footing with suppliers' other customers and conform to a common industry standard and practice. The grace period means extra carrying costs, which are a financial burden to all companies strapped with non-commercial payment terms and practices.

Taxpayers are no longer served by the 15-day grace period. In fact, after four years of experience with the 30-day law, agencies should already have implemented and enforced financial procedures that comply with statutory requirements.

The OMB's annual report to Congress shows that agencies are able to comply with the 30-day standard 99% of the time. The ALA believes this is sufficient evidence to show that the 15-day "bonus" period is no longer needed.

3. Delayed Interest Payments

ALA members complain loudly and often that, despite the intent of the Act and OMB Circular A-125, the government and military agencies with whom they do business routinely fail to provide for the automatic payment of "penalty" interest when a check is issued after the prescribed payment period. In many cases it simply becomes too tedious and time consuming for a company to seek redress where automatic interest penalties are not paid.

There are at least three practical reasons why this problem must be corrected. First, suppliers have no means to determine interest in advance because it cannot be known when the check will finally be issued by the agency. Second, to rebill for interest is costly and burdensome to both the government, which must then process another invoice, and to the supplier, which must issue the invoice for an indefinite amount. Third, the interest rate for penalty payments is recalculated every six months and is more easily known to the government than to the supplier.

The ALA believes that a technical clarification, such as that proposed in S. 328, will provide a meaningful remedy. The bill provides that interest "shall be paid without regard to whether the business concern has requested payment of such penalty." In addition, to effect agency compliance, the interest penalty is doubled when a supplier owed interest does not receive it with the payment and makes a written demand for the interest due.

4. Early Payment Discounts

Another routine practice reported by most ALA members concerns early payment discounts offered to and taken by agencies despite the fact that actual payment is made after the expiration of the specified discount period.

This flagrant abuse is extremely frustrating to suppliers who, as a rule, do not tolerate such blatant disregard for their payment terms by commercial accounts.

The solution to this problem is addressed by S. 328. The bill states that the specified time for early discount payments shall be calculated from the date the invoice under the contract is received by the designated payment office or finance center until the date of payment.

The ALA believes that the interest penalty in S. 328 should be doubled when an agency unfairly takes the early payment discount. The mechanism for the double penalty would work in the same way as the double penalty for non-automatic interest payments in S. 328.

5. Annual Reports

Annual OMB reports required by the 1982 Act overlook additional measures of prompt payment performance and problems. The Act requires annual reports showing the number, amounts, and frequency of interest penalty payments but does not give any measure of invoices paid, for example, after the required date for which no interest penalties were included. In other words, it is difficult to measure performance for agencies that exhibit disregard for the 1982 Act.

To make agencies more accountable, S. 328 specifies that annual reports will now be required to include the number, dollar value, and frequency of invoices paid late without payment of an interest penalty and the reasons no obligation to pay interest was incurred.

The ALA believes that, in addition to the provisions of S. 328, the Act should be amended to give Congress, in the annual OMB report, data on the time intervals consumed in receiving, acceptance, and certification functions.

The absence of such information would make it difficult to monitor performance of the proposed 5-day standard.

6. Notification of Defective Invoices

One problem area that begs for a remedy concerns the provision in the 1982 Act that requires agencies to give suppliers notice of an improper or defective invoice within 15 days of receipt of the invoice by the agency. In effect, the 30 days (plus 15 bonus days) on the payment clock are frozen until a proper invoice is submitted.

The original purpose for this provision was to prevent agencies from putting unpaid invoices into abeyance for months pending further action. It gave suppliers the benefit of an early warning of late payment and an opportunity to correct ommissions, errors, and mistakes.

It would be an understatement to say that some agencies are ignoring this 15-day provision. Not only are many suppliers not being notified of defective invoices but they must then devote scarce and valuable time to the frustrating experience of making followup telephone calls or writing letters, or both, to determine the status of unpaid bills.

This situation represents bureaucracy at its worst and should be remedied by providing for a penalty for agencies that ignore this notification requirement of the law. At a minimum, the OMB's annual report to Congress should provide data on agency compliance with this 15-day-notification provision. In turn, by asking for this information in its quarterly review of agency payment practices, OMB will inspire some agencies to dramatically improve compliance.

7. Appoint A Payment Ombudsperson

Anyone who has had to suffer the dizzying experience of trying to identify the one government agency person able to assist or answer a question will support the need for a "payment ombudsperson" of last resort--someone who will not file, report, refer or delegate the problem into the bureaucratice abyss. The ombudspersons for each agency should be identified, compiled and published in a list at frequent intervals by OMB, to include agency, ombudsperson's full name, address, and commercial telephone number with extension. The list should routinely be given by government contract and procurement officials to suppliers.

In addition, OMB should require every agency to publish information for suppliers about "How To Get Paid By This Agency." Some have already done so and all others should be required to follow suit.

8. Calculation Of Interest For Penalty Payments

The temptation for agencies to unfairly delay penalty payments to avoid unfavorable interest rates must be remedied. For large payments it is often in the agencies' interest to withhold payment until the interest penalty changes to a lower rate.

It was never intended that interest penalties be paid at the rate prevailing on the date of payment. OMB Circular A-125 states: "Whenever a proper invoice...is paid after the due date plus 15 days...interest will be included with the payment at the interest applicable on the payment date." Whether using the date the payment was due or the date the payment is made, agencies should be prohibited from delaying payments to take advantage of favorable interest rate fluctuations.

All government bills--including interest penalty payments--should be paid as promptly as possible.

9. Electronic Funds Transfer

The potential for electronic funds transfer (EFT) to speed up government payments is a concept whose time has come. The technology for making automatic payments at specified time intervals into suppliers' bank accounts can save countless millions of dollars to suppliers, government agencies, and ultimately taxpayers.

Unfortunately, little is known about the government's current use or potential application of this technology. The ALA believes that the Department of the Treasury and other appropriate agencies should undertake a study of the government's plan for expanded use of EFT.

It may interest the committee to know that the potential for application of EFTS technology in the military/government "resale industry" is already here. Employing electronic data interchange technology through Uniform Communication Standard software standards used in the commercial retail sector, many ALA members are currently conducting live tests of computer-to-computer purchase order and related data transmissions to military resale agencies to accelerate the order-delivery cycle that makes the retailing wheel go 'round. The resale agencies are currently working on software to automate their payment voucher examinations process, and the next logical step after these systems have been validated is to enhance the software to enable EFTS.

The ALA is working closely with these agencies to determine what role ALA members can play in bringing EFTS to fruition. It may be helpful for the committee to hold oversight hearings on the specific topic of EFTS in order that the models being developed, tested, and validated in the resale industry can be explained, understood, and possibly exported to other agencies within the federal government.

CONCLUSION

The ALA believes that, with appropriate amendments and technical improvements, the 1982 Prompt Payment Act will serve its intended purpose: To require the government to pay its bills in a timely fashion and to pay an interest penalty on late payments. In this statement, the ALA has indicated its support for S. 328 and additional recommendations which have surfaced during the course of dialogue with members and representatives of other organizations, most notably the Coalition for Prompt Pay.

We thank you for holding this hearing and stand ready to assist you in any way possible to resolve the endless struggles with problems related to prompt, and fair, payment.

ALA's 1986 Prompt Pay Survey

Summary & Highlights

Majority of suppliers work with payment terms of "Net 30 Days"

Average supplier needs average of 45 days to collect on "past due" accounts

Average supplier carries average of $521,010 in "past due" accounts . . . Up 61% since 1981

Military/government accounts continue to take unearned discounts

ALA's 1986 Prompt Pay Survey

Age Analysis of Accounts Collected Beyond Due Date, By Exchange Agency

(% of companies reporting average days accounts were overdue)

	Less Than 30 Days		30-60 Days		60-90 Days		Over 90 Days	
	1981	1986	1981	1986	1981	1986	1981	1986
AAFES	28	54	36	37	22	7	14	2
USCG	72	62	26	30	2	5	0	3
USMC	79	62	17	30	4	5	0	3
Navy	30	42	42	44	18	8	10	6
VCS	—	67	—	33	—	0	—	0

Note: VCS was not included in 1981 and 1986 survey questionnaires. Figures were volunteered by respondents.

ALA's 1986 Prompt Pay Survey

Since Congress passed the 1982 Prompt Payment Act...

- "slow pay" problems have continued
- payments are now, on average, slower than ever
- alarmingly, average dollar amount of "past due" has risen 61%

Solutions. . .

- close loopholes in 1982 Prompt Payment Act
- improve communications to resolve problems.

ALA's 1986 Prompt Pay Survey

Average Number of Days Required to Collect On Accounts Beyond Due Date, By Agency

Agency	1981	1986
Army & Air Force Exchange Service (AAFES)	52	37
Air Force Commissary Service (AFCOMS)	32	36
Coast Guard Commissaries	23	39
Coast Guard Exchanges	23	32
Defense Personnel Support Center (DPSC)		64
Marine Corps Commissaries	24	39
Marine Corps Exchanges	22	33
Navy Commissaries	24	39
Navy Exchanges	47	46
US Army Troop Support Agency (TSA)	42	49
Veterans Canteen Service (VCS)		27
Sales-weighted Average*	**44**	**45**

Note: DPSC and VCS were not included in 1981 and 1986 survey questionnaires. Figures were volunteered by respondents.

ALA's 1986 Prompt Pay Survey

Age Analysis of Accounts Collected Beyond Due Date, By Commissary Agency

(% of companies reporting average days accounts were overdue)

	Less Than 30 Days		30-60 Days		60-90 Days		Over 90 Days	
	1981	1986	1981	1986	1981	1986	1981	1986
AFCOMS	47	54	47	39	6	5	0	2
DPSC	—	38	—	12	—	38	—	12
USCG	72	62	28	29	0	6	0	3
USMC	64	51	36	41	0	6	0	2
Navy	42	42	35	51	13	5	10	2
TSA	40	44	41	46	17	7	2	3

Note: DPSC was not included in 1981 and 1986 survey questionnaires. Figures were volunteered by respondents.

ALA's 1986 Prompt Pay Survey

Suppliers' Payment Terms With Military Commissaries & Exchanges

1981 vs. 1986
(% offering each type)

	Commissaries		Exchanges	
Terms	1981	1986	1981	1986
Net 10	10	3	15	3
Net 15, with Cash Discount 10 Days	2	2	3	3
Net 15 Days	4	3	1	2
Net 30, with Cash Discount 10 Days	18	19	26	13
Net 30 Days	66	52	55	49
	100%	79%	100%	70%
Other (from "Net 7" to "Net 60 with Cash Discount 45 days")		21		30
		100%		100%

ALA's 1986 Prompt Pay Survey

Average $ Amount of Military Accounts Past Due

	1981		1986
Total $ Amount Past Due*	$41.6M	**UP 10%**	$45.9M
Average $ Amount Past Due*	$324,000	**UP 61%**	$521,010
Highest $ Amount Past Due	$2.4M		$10.1M
Lowest $ Amount Past Due	$5,000		$225

*Based on aggregate totals from all respondents.

AMERICAN LOGISTICS ASSOCIATION
1986 PROMPT PAY MEMBERSHIP SURVEY

TABULATED RESULTS

Table 1. Payment Terms Offered To Military Commissaries, 1986 vs. 1980

Terms	Number of Respondents	% 1986	% 1980
N7	4	6.0	-0-
N10	2	3.0	10.0
N12, with cash discount 12 days from receipt of invoice or receipt of delivery, whichever is later	1	1.5	-0-
N14	1	1.5	-0-
N15	2	3.0	4.0
N15, with cash discount 10	1	1.5	2.0
N30	35	52.2	66.0
N30, with cash discount 10	13	19.4	18.0
N30, with cash discount 14	2	3.0	-0-
N30, with cash discount 15	3	4.4	-0-
N31, with cash discount 30	2	3.0	-0-
N46, with cash discount 45	1	1.5	-0-
	67	100.0	100.0

Table 2. Payment Terms Offered To Military Exchanges, 1986 vs. 1980

Terms	Number of Respondents	% 1986	% 1980
N7	2	2.6	-0-
N10	2	2.6	15.0
2% 10th and 25th days (all except AAFES)	1	1.3	-0-
2% 10th and 25th days (all)	1	1.3	-0-
2% 30 days (AAFES only)	1	1.3	-0-
2% 30 days (all)	3	3.9	-0-
N11, with 2% cash discount 10	1	1.3	-0-
N12, with 1% cash discount 12 days from receipt of invoice or receipt of delivery, whichever is later	1	1.3	-0-
N15	2	2.6	1.0
N15, with cash discount 10	2	2.6	3.0
N21, with 2% cash discount 20	1	1.3	-0-
N30	38	49.3	55.0
N30, with cash discount 10	10	13.0	26.0
N30, with cash discount 14	2	2.6	-0-
N30, with cash discount 15	3	3.9	-0-
N30, with 2% cash discount 20	1	1.3	-0-
N31, with 2% cash discount 30 (USCG/Navy/USMC only)	1	1.3	-0-
N31, with 3% cash discount 30	1	1.3	-0-

Table 2. (continued)

Terms	Number of Respondents	% 1986	% 1980
N56, with cash discount 55	2	2.6	-0-
N60	1	1.3	-0-
N60, with 2% cash discount 45	1	1.3	-0-
	77*	100.0%	100.0%

*There were several multiple responses from individual respondents.

Table 3. Average $ Amount of Military Accounts Past Due, 1986

Respondents With:	Total $ Amount	Highest $ Amount	Lowest $ Amount	Average $ Amount
Commissary Business Only				
Manufacturers (5)	2,513,924	1,942,000	7,000	502,785
Brokers (1)	25,000	25,000	25,000	25,000
Distributors (11)	573,938	180,000	1,326	52,176
Total (17)	3,112,862	1,942,000	1,326	183,110
Exchange Business Only				
Manufacturers (10)	1,137,279	552,953	2,923	113,728
Brokers (0)	-0-	-	-	-0-
Distributors (1)	280,000	280,000	280,000	280,000
Total (11)	1,417,279	552,953	2,923	128,844
Commissary & Exchange				
Manufacturers (44)	30,033,880	5,000,000	800	682,588
Brokers (3)	454,371	327,371	11,000	151,457
Distributors (13)	10,875,522	10,100,000	225	836,579
Total (60)	41,363,773	10,100,000	225	689,396
All Respondents (88)*	45,848,914	10,100,000	225	521,010

* In addition to the total of 88 respondents, there was no response from 4 manufacturers, 2 brokers, and 2 distributors.

Table 4. Average Number of Days Required Beyond The Due Date to Collect Past due Accounts, By Agency, 1986 vs. 1980

Commissary Agency	1986	1980
Marine Corps	39	24
Coast Guard	39	23
Navy	43	42
Army (TSA)	49	42
Air Force (AFCOMS)	36	32
Defense Personnel Support Center (DPSC)	64	--
Exchange Agency		
Marine Corps	33	22
Coast Guard	32	23
Navy	46	47
Army & Air Force Exchange Service (AAFES)	37	52
Veterans Canteen Service (VCS)	27	--

NOTE: The DPSC and VCS were not included in the 1986 survey because they were not surveyed in the ALA's benchmark 1980 study.

Table 5. Average Number of Days Required To Collect On Overdue Accounts, By Agency, 1986 vs. 1980, With Sales Weighted Average

	FY85 $ Sales	1986 Average	1986 Weighted Average	1980 Weighted Average
Veterans Canteen Service	101,894,060	27	27.3	N/A
Coast Guard Exchanges	51,871,827	32	32.2	23
Marine Corps Exchanges	264,549,303	33	33.7	22
AFCOMS	2,058,410,575	36	43.4	32
AAFES	3,922,028,000	37	51.4	52
Coast Guard Commissaries	5,000,000	39	39.0	23
Marine Corps Commissaries	162,689,016	39	39.6	24
Navy Commissaries -	802,724,957	43	46.4	42
Navy Exchanges	1,101,850,002	46	51.1	47
TSA	1,573,647,597	49	63.6	42
DPSC	-0-	64	64.0	N/A
Weighted Average*	-0-	N/A	45.0	44

* Based On Agency FY85 Retail Sales.

NOTE: FY85 combined retail sales (commissaries and exchanges) was $10,044,665,337.

Table 6. Age Analysis of Overdue Accounts By Agency, 1986 (percent of companies reporting average days accounts were overdue)

	Less Than 30 Days	30-60 Days	60-90 Days	Over 90 Days
Coast Guard Exchanges	68	26	3	3
Veterans Canteen Service	67	33	-	-
Marine Corps Exchanges	62	30	5	3
Coast Guard Commissaries	62	29	6	3
AFCOMS	54	39	5	2
AAFES	54	37	7	2
Marine Corps Commissaries	51	41	6	2
TSA	44	46	7	3
Navy Exchanges	42	44	8	6
Navy Commissaries	42	51	5	2
DPSC	38	12	38	12

Table 7. Average Number of Days Required To collect on Overdue Accounts, By Exchange Agency Region, 1986

AAFES Region	1986 Average
Alamo	42
Capitol	44
Golden Gate	41
Ohio Valley	44
Southeast	41
Europe	38
Pacific	39

Table 8. Average Number of Days Required To Collect On Overdue Accounts, By Exchange Agency Region, 1986

Navy Exchanges

FSO/Region	1986 Average
Auburn	36
Corpus Christi	34
Davisville	41
Great Lakes	39
Jacksonville	45
Mechanicsburg	52
Norfolk	47
Oakland	37
Pensacola	46
Patuxent	40
San Diego	44
Europe/Caribbean	43
Pacific/Far East	43

Table 9. Average Number of Days Required To Collect On Overdue Accounts, By Exchange Agency Region, 1986

Marine Corps Exchanges	1986 Average
All Exchanges--No Regions	38

Table 10. Average Number of Days Required To Collect On Overdue Accounts, By Exchange Agency Region, 1986

Coast Guard Exchanges District	1986 Average
1st	40
3rd	43
5th	36
7th	39
8th	39
9th	39
13th	38
14th	40
17th	40

Table 11. Average Number of Days Required To Collect On Overdue Accounts, By Commissary Agency Region, 1986

AFCOMS Region	1986 Average
California	34
Delta-Gulf	34
Northeast	33
Northwest	38
North Central	32
Southeast	34
Southwest	35
South Central	34
Europe	49
Pacific	46

Table 12. Average Number of Days Required To Collect On Overdue Accounts, By Commissary Agency Region, 1986

TSA Region	1986 Average
Northeast	49
Southeast	54
Midwest	36
Western	33
Europe	64

Table 13. Average Number of Days Required To Collect On Overdue Accounts, By Commissary Agency, 1986

NAVY

Region/FSO	1986 Average
Auburn	38
Corpus Christi	35
Davisville	42
Great Lakes	38
Jacksonville	37
Norfolk	42
Oakland	38
Patuxent River	36
Pensacola	36
San Diego	43
Europe/Caribbean	48
Pacific	57

Table 14. Average Number of Days Required To Collect On Overdue Accounts, By Commissary Agency, 1986

Marine Corps Region/Complex	1986 Average
East Coast	41
West Coast	31

ALA's 1986 Prompt Pay Survey
July 1986

Comments From Respondents' Questionnaires

1. "Since we changed our terms to 2% 55, net 56 our overdue has dramatically dropped."

2. "I think a business should be able to have terms of 20 days net. We have to pay our bills in 20 days or less; why shouldn't the government?"

3. "The problems with collections are ongoing and seem to have no end to them. Most of them seem to center around red tape."

4. "When we sometimes make calls about serious past dues, we're told that all they need is a copy of the invoice, and that they have confirmed receipt of the goods, etc. Why aren't requests for invoice copies automatically sent here if they know the goods are received?"

5. "As a distributor, most business is done by manufacturer paying us rather than base. What they [the military] buy from us on bid usually takes too long to collect. Their attitude for justifying slow payment seems to be changing, and if you check on delinquent bills soon after due date and often, we've found they pay quickly after an inquiry."

6. "We seem to run into problems when the bases deduct for VPRs no longer in effect. Also, it seems we're not notified of a billing charge until we send an invoice to the wrong location."

7. "We get the money--BUT SLOW."

8. "I've found that Miramar [Navy commissary] loses our invoices and takes 60 days to send payment. Los Angeles AFS [commissary] also has a problem with losing invoices. Camp Pendleton and 29 Palms [Marine commissaries] are always outstanding 30 days as they wait until a group of call numbers are received before they submit payment. Can they pay invoices individually?"

9. "We give [terms of] net 30 days, which should be ample time to remit. The average payment time is 45-50 days. These extra 15-20 days create some problems for small businesses' cash flow, resulting in higher prices to the commissary."

10. "We currently have $80,000 outstanding to all military accounts, or one-third of total sales. For your information, we're a meat processing plant."

11. "We do not have an agency to collect our past due accounts. Our military department handles this. I put [on questionnaire] 60+ days [for all military accounts] because I don't have the time to research exactly how long it takes [for different accounts, by location]. I'm enclosing a copy of my past due accounts report. Maybe this will help you. Since I'm the only one in the military department to handle this, I just act by what this report says. Most of the accounts that are past due are that way because of a problem with a PO#, call#, or any number of reasons. I don't run into past due accounts just because they are unwilling to pay very often. Our terms are net 30, with cash discount 10 days; still, not many bases pay when they should. I start making,

calls and sending copies when the number of days past due hits 20 on my report. What's more, most bases take the cash discount—even if the account is 60 days past due!"

12. "We get constant complaints from our finance department about SLOW PAY by all military accounts."

13. "[The military is] extremely difficult to work with. They take an additional 30 days to pay after the invoice has been re-submitted for any reason—minor adjustments to call#, PO#, lost in accounting office, etc. We've sent as many as 3 'signed receipt requests' to a paying office, and they still claim it was not received. Multiple problems."

14. "Ft. Lee [Army commissary] generally pays 60-70% within 60 days of invoice date. The 30-40% not paid within 60 days are very difficult to collect, if collected at all. Recently, we have seen improvement at Ft. Meade [Army commissary], but they're still paying the majority of their invoices in 45-60 days."

15. "Lost invoices are paid 7 days after invoice is received. This can cause invoices to be paid 18-24 days slow." [Comment from a meat company with terms of net 7 days.]

16. "Policy should be to make payment and deduct discrepancies--not to hold entire invoice for minor discrepancies.

When invoices fall past due, repeated collection letters and calls to successively higher levels of authority are needed--Navy in particular."

17. "Any help to speed up payments is greatly appreciated."

18. "Payments from DPSC are the worst; collections for past due receive little cooperation." [DPSC was not included in the questionnaire--information was volunteered.]

19. "In addition to slow paying generally, there are always problems in reconciling overdue invoices. Some of the reasons: Lack of personnel to handle payments, and new people on the job because of personnel turnover."

20. "We are receiving a great deal of pressure from our financial accounting groups. We have even suggested "cutting off" some TSA and DPSC shipments if payment problems don't get better. We have a real problem that must be fixed!" [From a manufacturer with $5 million outstanding in past dues. DPSC was not in the questionnaire—information was volunteered.]

21. "Both the Navy and Marines [commissaries and exchanges] are very slow to pay. The Marines have very poor paperwork procedures, and continue to lose invoices." [From a distributor with $200,000 outstanding in past dues.]

22. "Navy is much too slow (some of our overdue accounts with Navy exchanges are up to a year old)! We get frequent requests for proof of deliveries.

In comparison to the civilian trade, the military commissaries and exchanges are terribly slow and inefficient."

23. "I have problems with AAFES and Navy [exchanges] answering letters, or they promise to return calls but never do."

24. "It's better than it was 5 years ago. The Army [commissary] regions pay up

when they are prodded—all proof is on manufacturer. The Navy seems to lose documents, and proof of delivery must be furnished—which means more delays."

25. "TSA [Europe] and AFCOMS [Europe] comprise 62% of our total accounts receivables over 60 days. TSA Norhteast and Southeast Regions are the worst in domestic U.S. However, from month to month, they all can vary."

26. "Navy's San Diego FSO [exchanges] pays us an average of 90 days past due date on our terms of net 30—that's 120 days from the date we issued invoice."

27. "Skipped invoices take over 60 days to resolve. Many locations are very uncooperative and very bureaucratic." [From a manufacturer with $2 million outsanding in past dues.]

28. "Because our company changed its name, we've experienced added delays in payments since May 1986--with emphasis on TSA headquarters and TSA Northeast Region.

"Coast Guard's Training Center and Opa Locka, Fl [exchanges] are 8 and 38 days, respectively, on average number of past due dates."

29. "Regarding 'overdue amounts,' in all fairness some of them are disputed items such as freight charges, shortages, and pricing differences; these discrepancies require time on both sides to research and resolve."

30. "Army and Navy commissaries abuse the 15-day grace period. Both have stated they use the 15 days as part of the terms to pay most invoices.

"Interest is never automatically paid, although it is due--except by the Marines and Coast Guard who purchase small quantities." [From a distributor with an average of $10.1 million outstanding on past dues.]

31. "We are experiencing major delays and confusion with Navy in the continental U.S. due to the elimination of direct pay." [From a manufacturer with $1.3 million outstanding in past dues.]

32. "Coast Guard's Opa Locka exchange is average of 109 days past due--that's beyond the original 30 days. Their Governors Island and Otis exchanges are overdue by an average of 63 and 53 days, respectively." From a manufacturer with $1.1 million outstanding.]

33. "Navy [exchanges] at Davisville and Norfolk FSOs are past due [beyond original 30 days] by average of 104 and 95 days, respectively."

34. "We have, on occasion, had a commissary claim a shortage in their shipment, even though we have submitted to them a clean bill of lading. When this was discussed with the regional director, the regional director clearly understood that our bill of lading was a legal document and payment was therefore due. This fact should be impressed upon payment offices. We have found payment offices to be generally slow in answering our inquiries regarding discrepancies in payments."

35. "We send all correspondence concerning late payments by certified mail. However, even using this method, TSA Southeast region still loses paperwork and is still slow about paying."

36. "Our company changed in Nov. '85 from payment terms of net 30 days to 1% discount 14 days. The reason for the change: net 30 days was in reality from

50-60 days until we got the check. Now, with the discount terms 1% within 14 days, we get the check after 20 days; that means the money is credited to our bank account after 22-23 days after sending invoices." [From a manufacturer with $200,000 outstanding in past dues.]

37. "Within our company's Eastern Division, Bolling and Andrews [AFBs commissaries] pay an average of 47 days past the original 30 days. Within our Central Division, all commissaries and exchanges pay an average of 60 days beyond the original 30. Within our Western Division, Ft. Sam Houston [Army commissary] still causes problems, with some old invoices still unpaid."

38. "Our requests for contacts at each facility have not been answered. It would make our job a lot easier if we could obtain a [name and phone number] contact."

39. "Any help reagrding these ongoing payment problems would be greatly appreciated."

40. "Their [the military's] 30 days is after they receive invoice. They then take an additional 15-day grace period (we don't reeive any interest). When we give them information about past dues, they also want copies sent. We always have to send them copies 4 or 5 times, plus put phone calls in to them. Some [service branches] send our invoices to the corporate office to be paid--the corporate office then pays us 30 days after they receive it!"

41. "We have numerous commissary accounts with an average of 10.2 days required."

42. "AAFES exchange regions in Continental U.S. are pre-billed, invoice with shipments. Exchanges pay within 30 days of receiving invoice or copy." [From manufacturer supplying exchanges only, with $552,953 outstanding in past dues.]

43. "We carried almost $40,000 in receivables to the U.S. government for about 6 months. this has happened several times now. TSA Northeast Region is past due by average of 120 days or more--this is worst situation to date." [From a small business broker with $11,000 outstanding in past dues.]

44. "Most agencies pay on time, but we do have serious payment problems occasionally with NAVRESSO, Staten Island, NY; TSA Northeast Region, Laurel, MD; and DPSC, Phila., PA. All of the above are currently running 30 days slow."

45. "Navy commissaries and exchanges are currently an average of 90 days behind on payments, beyond original 30 days."

46. "The Prompt Payment Act is not followed consistently throughout all branches and agencies of the military. A trend seems to be developing where the Act is being interpreted to fit payment schedules among various disbursement offices, while continuing to take 'cash discount.'" [From manufacturer with $120,000 outstanding in past dues.]

47. "All Navy exchange FSOs take an average of 73 days beyond original 30 to pay."

48. "AAFES' Alamo and Golden Gate Regions are both average of 90 days overdue--beyond orininal 30. Navy's San Diego and Oakland FSOs [for exchanges] are both running an average of 120 days beyond the 30."

49. "With correct invoicing, the past dues are being eliminated." [From manufacturer with $4 million in past dues.]

50. "We don't use a collection agency. Normally, it takes average of 30 days to collect overdue commissary and exchange accounts. Occasionally, a rush order will be put on the processing of an invoice, and we then receive payment within 5-10 days. Exception to this is where they claim no invoice was received, which starts payment cycle all over again."

51. "Please note that I've been trying to collect on some past due invoices from TSA Midwest Region since last October, 1985. They are 9 months past due. I've talked to everyone in finance to no avail--but they always say they're current.

"We're a small business (5 employees) and, where we recently for example carried $35,000 in past dues for 5 months, it causes our company considerable hardship." [From a distributor with $125,000 in past dues.]

52. "We're a manufacturer with a current total of $71,619 outstanding in past dues--$56,498 of which is due from DPSC, Phila., PA."

53. "Once items are 100 days past due, resolution is very difficult because the regions need to wait for replies from the military exchanges, which delays payment." [From manufacturer supplying exchanges only, with terms of net 60 days.]

54. "We supply exchanges only. Our terms are net 30 days. Still, we have $5-10,000 past due with AAFES and the Veterans Canteen Service, and another $200,000 outstanding with the Navy and Marines. Plus another $75,000 outstanding with Navy ships afloat.

55. "DPSC is by far the worst government account we sell. they often take deductions in error; skip invoices; and generally are slow to pay. we receive very little cooperation from personnel we contact, who usually say they'll call back with an answer, but never do. We never receive interest for late payments--we must bill for this and go through a hassle to collect. The attitude always seems to be 'I couldn't care less about your problem.' They need competent people who are organized, concerned, and have initiative (to get off their rears and get the work done). We're still trying to clear up a skip from November 1985, and numerous deductions as high as $1,000 dating back to December 1985. Other than DPSC, Navy commissaries are the slowest branch--21 days slow." [From manufacturer with $140,000 in past dues.]

56. "We're a manufacturer serving over 250 military accounts. we have no serious payment problems with 99% of these accounts. However, the following need constant follow-up: Bolling AFB [commissary] 30 slow; McGuire AFB [commissary] 30 slow; DPSC, Phila., PA 30-90 slow--there's been a slight improvement over last 2 months; Ft. Lee [TSA/SECOR] 30-60 slow, and almost always refuses to give out info over phone; Ft. Meade [TSA/NECOR] 30-60 slow, telephone is always busy!; and Ft. Lewis [TSA/WCOR] 30-60 slow, but very cooperative when we call." [From manufacturer with $310,000 in past dues.]

57. "Both DPSC [Phila, PA] and TSA NECOR are going to 60-90 days past due!" [from a small business broker with $116,000 in past dues.]

58. "We sell to commissaries and exchanges. our worst problems are with exchanges. AAFES' regions pay promptly, with exception of Southeast, which pays average of 90 days slow."

59. "Navy's San Diego FSO [for commissaries and exchanges] is running average

of 45 days slow."

60. "It would be very helpful if the name of a contact at each location's accounts payable dept. was made available. Or at least provide the A/P dept's direct phone number.

"Marine exchanges pay on time. Navy Norfolk [commissary] pays average 60 days slow."

61. "AAFES' Capital, Ohio Valley and Southeast regions are average of 120 days slow; Alamo and Golden Gate are average of 90 slow." [From manufacturer.]

62. "Marine's East Coast Complex commissaries are 90 days slow. TSA's SECOR is 1 year slow. AFCOMS Southeast and Delta-Gulf regions are average of 3 months slow."

63. "Copies of invoices are continually sent. No response. On some holiday items, they're now asking for checks for guaranteed sale--when original bill was not paid. Navy Norfolk is average of 120 days slow; TSA NECOR and SECOR are both 180 days slow." [From manufacturer.]

64. "Navy commissaries and exchanges have a high rate of shortages, returns, and other discrepancies, such as deductions from payments without explanation. While invoice numbers are usually identified on the remittance advices, the invoice dates are freuqently omitted, e.g., NAVRESSO, Staten Island, NY. Moreover, the Navy's check processing systems are quite slow. Also, an inordinate amount of skipped invoices from both types of customers, i.e., commissaries and exchanges, exist.

"In addition, the home port listings, e.g., FPOs, remain a mystery once these ships are at sea on a mission. This could be alleviated by providing suppliers with the DD 1155s before the orders are delivered. Also, the Norfolk Fleet paying office is difficult to contact, despite several extension numbers provided.

AMERICAN LOGISTICS ASSOCIATION
1133 Fifteenth Street, N.W. / Suite 500 / Washington, D.C. 20005 / (202) 466-2520
Telex: 6502459439

July 14, 1986

Please respond
by August 1

MEMORANDUM

TO: ALA Voting Members

FROM: Alan Goldstein

SUBJECT: Prompt Payment

At the last ALA Board of Directors meeting in June, the continuing problems associated with prompt invoice payments were discussed. As a result, the Board appointed Bill Hance to chair a newly-created ALA Prompt Payment Task Force to study the issue and report findings to the resale systems.

Your cooperation in completing the enclosed questionnaire, based on the ALA's slow pay survey of 1980, will help the Task Force to quantify the problem. Results will be compared to findings from the 1980 survey and thus provide a benchmark against which problems may be measured.

As with the 1980 survey, due to sensitivity about furnishing financial data, your company's response will be safeguarded to maintain complete confidentiality. DO NOT send your completed questionnaire to ALA headquarters. Forward your response to ALA's general counsel, John Diuguid:

John Diuguid, Esq.
Diuguid & Epstein
1000 Connecticut Avenue, N.W.
Suite 1107
Washington, D.C. 20036

It would be helpful to have your response no later than Friday, August 1. Please do not hesitate to call me at ALA headquarters if you have any questions about the questionnaire.

Thank you for your cooperation and assistance in this important matter.

AMERICAN LOGISTICS ASSOCIATION

PROMPT PAY SURVEY QUESTIONNAIRE

1. What are your current payment terms with military commissaries and exchang

(check only one in each column)

	Military Commissary	Military Exchange
Net 10 days	________	________
Net 15 with Cash Discount 10 days	________	________
Net 15 days	________	________
Net 30 with Cash Discount 10 days	________	________
Net 30 days	________	________

2. What is the current average dollar amount of your overdue military account
receivable? $________________

3. What is the current average number of days required to collect on overdue accounts, by agency?

	Commissaries	Exchanges
Marine Corps	____________	_________
Coast Guard	____________	_________
Navy	____________	_________
TSA	____________	
AFCOMS	____________	
AAFES		________

4. What is the current average number of days required to collect on overdue accounts, by agency region/complex/FSO?

Commissaries

Marine Corps Complexes
  East Coast _____
  West Coast _____

TSA Regions
  Northeast _____
  Southeast _____
  Midwest _____
  Western _____

  Europe _____

Exchanges

AAFES Regions
  Alamo _____
  Capitol _____
  Golden Gate _____
  Ohio Valley _____
  Southeast _____

  Europe _____
  Pacific _____

(continued on reverse)

AFCOMS Regions
California ______
Delta-Gulf ______
Northeast ______
Northwest ______
North Central ______
Southeast ______
Southwest ______
South Central ______

Europe ______
Pacific ______

Navy Regions/Groups
Auburn ______
Corpus Christi ______
Davisville ______
Great Lakes ______
Jacksonville ______
Norfolk ______
Oakland ______
Patuxent ______
Pensacola ______
San Diego ______

Europe ______
Pacific/Far East ______

Navy FSOs
Auburn ______
Corpus Christi ______
Davisville ______
Great Lakes ______
Jacksonville ______
Mechanicsburg ______
Norfolk ______
Oakland ______
Pensacola ______
San Diego ______

Europe/Caribbean ______
Pacific/Far East ______

Coast Guard Districts
First ______
Third ______
Fifth ______
Seventh ______
Eighth ______
Ninth ______
Thirteenth ______
Fourteenth ______
Seventeenth ______

5. Do you have any additional comments?

Thank you for your participation in this survey. Return this completed questionnaire to:

John Diuguid, Esq.
Diuguid & Epstein
1000 Connecticut Avenue, N.W.
Suite 1107
Washington, D.C. 20036

Associated
Builders and
Contractors, Inc.

729 15th Street, N.W.
Washington, D.C. 20005
(202) 637-8800

The Prompt Payment Act Amendments of 1987

S. 328

Associated Builders and Contractors (ABC) appreciates the opportunity to comment on implementation of P.L. 97-177, the Prompt Payment Act of 1982, and S. 328, the Prompt Payment Act Amendments of 1987.

ABC is a national construction industry trade association representing 19,000 construction general contractors, subcontractors, suppliers and other construction employers. ABC members adhere to the Merit Shop construction philosophy and believe that construction contracts should be awarded in fair and open competition to the lowest responsible bidder, regardless of labor affiliation.

Consistent with the concept of cost-effective construction, ABC worked hard for and applauded passage of the Federal Prompt Payment Act of 1982 when considered by the 97th Congress.

Though ABC felt it unfortunate that federal agencies required prompting to comply with common sense business practices, P.L. 97-177 was viewed as an effective way to make the federal government more reliable in business dealings with federal contractors.

Always a strong proponent of competition and efficiency, ABC expected P.L. 97-177 to lower costs for both government and contractors by eliminating the expenses and headaches incurred in collecting payment from federal agencies for goods and services delivered. Less red tape was viewed as an attraction to lure new, capable businesses into competition for government contracts, thus fostering competition and cost-effectiveness.

As many ABC members and a lot of other federal contractors now know, P.L. 97-177 has not been as effective as originally intended.

A recent analysis of federal agency payment practices completed in 1986 by the General Accounting Office (GAO) found that much improvement was still needed in the area of bill payment by federal agencies, even though agencies have had four years to adjust to the requirements of prompt pay. It concluded that the federal government continues paying more than 25 percent of its invoices late and that interest penalties which should be assessed for late payment often go unpaid. In fact, GAO found unpaid interest penalties at 24 of the 39 federal payment centers it audited!

In addition, agencies have chosen to ignore the applicability of P.L. 97-177 to construction progress payments and retainage despite ample legislative history instructing them otherwise. By refusing to comply with prompt pay rules, the federal government drives up the cost of federal construction contracts by forcing contractors to shoulder the unfair financial burden of late payments.

ABC believes its time to close these loopholes to make the Prompt Pay Act as effective as its original sponsors, many of whom are members of this committee, intended back in 1982.

We also support elimination of the 15 day grace period now exploited by some agencies to provide a 45 day instead of a 30 day payment period. The grace period was originally intended to give agencies time to adjust to prompt pay rules. Four years later, it is apparent that agencies have adapted to the transition rule but not the law.

Agencies add insult to injury by ignoring current law and forcing contractors who have received late payment to actually request the interest penalties due them. ABC endorses the clear, unequivocal provision in S. 328 reminding agencies that interest penalties are automatic.

ABC strongly supports the clarity provided by S. 328 with regard to "receipt of invoice". Explicit definition of "receipt of invoice" prevents delayed receipt as an excuse to delay the start of the 30 day "payment clock".

The 19,000 members of ABC and their employees express our thanks to those members of the committee who have already cosponsored this much-needed legislation. We applaud Senator Trible and Senator Sasser for their strong leadership on this issue.

S. 328 is strong, positive legislation. ABC looks forward to working with the committee in passing these critical legislative amendments to reform our federal prompt pay laws.

Associated
Builders and
Contractors, Inc.

729 15th Street, N.W.
Washington, D.C. 20005
(202)637-8800

April 29, 1987

The Honorable John H. Glenn, Jr.
United States Senate
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Glenn:

Associated Builders and Contractors (ABC) strongly urges you to support S. 328, the Prompt Payment Act Amendments of 1987, including Section 7, Prompt Pay for Subcontractors, during Government Affairs Committee markup on April 30.

ABC is a national construction industry trade association representing 19,000 general contractors, subcontractors, and construction industry suppliers. ABC members adhere to the Merit Shop construction philosophy and believe that construction contracts should be awarded to the lowest qualified bidder regardless of labor affiliation.

As you know, one provision sparking debate about S. 328 is Section 7 which requires prompt pay for subcontractors by general contractors on federal projects. Though ABC supports the right of subcontractors to receive timely payment for services rendered and has always urged our members to adhere to sound, equitable business practices, we have chosen in the past to remain neutral with regard to a federal requirement.

However, after extended analysis and discussion, ABC now believes that if a federal mandate is required to ensure subcontractor prompt pay on federal projects, it should be designed along the following guidelines.

ABC SUPPORTS subcontractor prompt pay legislation if it encourages all members of the building team to include a reasonable payment provision in their contract, that such agreement result in timely payment for all parties once general contractors have received payment from the federal government, and that prompt pay requirements NOT apply when a dispute exists with regard to performance or payment. ABC strongly encourages both general contractors and subcontractors to pay suppliers in a timely fashion as well.

ABC believes that Section 7 is a good faith effort to meet these guidelines and urges the committee to pass S. 328 in its entirety.

Thank you for your time and consideration.

Sincerely,

Charles E. Hawkins, III, CAE
Vice President, Government Affairs

Merit Shop Builds Best

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

ALBERT D. BOURLAND
VICE PRESIDENT
CONGRESSIONAL RELATIONS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062
202/463-5600

April 3, 1987

Senator John Glenn, Jr.
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The U.S. Chamber of Commerce strongly supports the thrust of S. 328, the "Prompt Payment Act Amendments of 1987," and requests that this letter be made a part of the hearing record.

As you know, S. 328 is identical to legislation, S. 2479, that was passed by the Senate on October 15, 1986. It would improve the Prompt Payment Act (P.L. 97-177) to ensure that government contractors are paid on time and that interest penalties are paid in instances of late payment.

For many years, the business community had been frustrated by the failure of the federal government to pay its bills in a timely manner. This concern was highlighted by the 1980 White House Conference on Small Business, which called for a legislative solution to the problem.

The business community has been pleased with improved government performance in paying its bills since the Prompt Payment Act became effective on October 1, 1982. But there is still concern, especially among small businesses, that some agencies have not met the legislative intent of Congress. The General Accounting Office (GAO) released a study in July, 1986, which substantiated these concerns. The GAO found that 25 percent of invoices were still paid late and interest penalties were not being paid in many instances. In some cases there were implicit policies not to pay late-payment interest due unless specifically requested. Also, some "quick pay" discounts were taken by the government after the discount period expired, and the discounts were not repaid unless specific requests were made.

These actions and practices of some federal agencies particularly damage small business suppliers, which depend heavily on cash flow and often do not have the resources to battle the federal bureaucracy over late or incorrect payments. Ultimately all taxpayers and citizens are injured because fewer businesses choose to sell to the government. This decreased competition raises the cost of goods and services purchased by the government.

The prompt payment issue ranked high again at the 1986 White House Conference on Small Business and was crystallized in a final recommendation of that Conference. The Senate addressed small business's concerns when it passed S. 2479 last year. Unfortunately, the House did not have time to consider this legislation.

The Chamber offers the following comments on the provisions of S. 328:

First, it is essential that the definition of "receipt of invoice" be clarified. Many Chamber members have complained that agencies have too much control over which action triggers the 30-day time period for payment purposes. The government needs flexibility to insure that goods and services delivered comply with contract specifications. The bill addresses these situations by allowing the government to notify contractors of any time needed to insure contract compliance before contracts are awarded. Once a business has been notified of such a necessity, it can make the appropriate adjustments in its bid offering.

Second, the bill clarifies that payment of interest must be made automatically on late payments. This is essential to the consistent functioning of federal agencies.

Third, the bill phases out the 15-day grace period by October 1, 1990. Too often, agencies have used the 15 days as an automatic extension of the 30-day payment period, which was not the Congressional intent in the original legislation. The Chamber is aware that this change is of concern to the Executive Branch but believes the phase-in, when combined with improvements in automatic payment procedures, will be a workable and fair approach.

Fourth, the Act now will apply to progress and periodic payments. This was the intent of the original legislation, and S. 238 clarifies this intent. There is no arguable difference between progress payments, periodic payments, and a final payment.

Fifth, the prohibition of "quick pay" discounts being taken after the expiration of the discount period is another sensible change. The federal government should expect no different treatment than a private-sector customer in dealing with its suppliers.

Sixth, including the U.S. Postal Service under the Act's coverage, directing the Office of Management and Budget to improve its reports to Congress, and requiring that the Act be implemented through the Federal Acquisition Regulations are further improvements that will clarify Congress's original intention when it passed the Prompt Payment Act.

Finally, the Chamber does not have a position regarding Section 7, the prime contractor-subcontractor language. The Chamber's policymaking committees are reviewing this language in an attempt to develop its position.

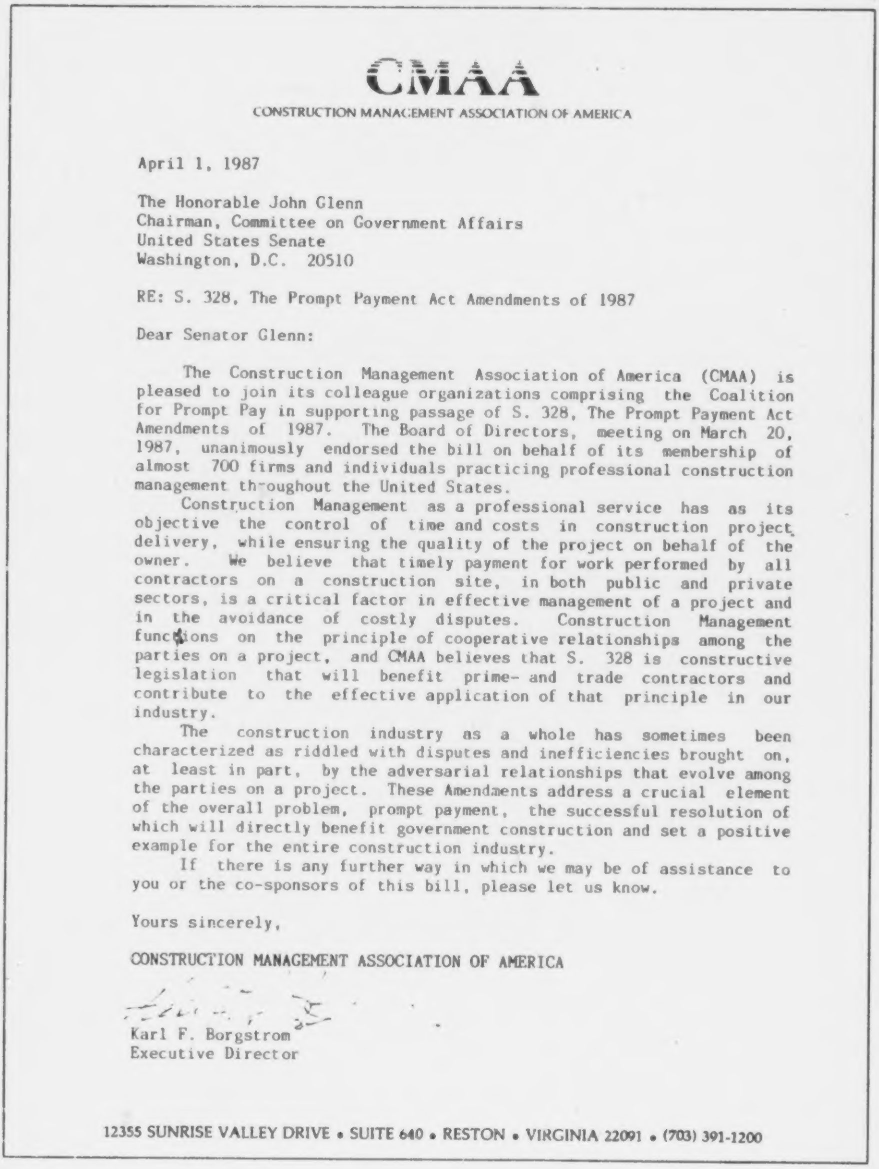
The Chamber appreciates the opportunity to have its remarks included in the hearing record on this legislation.

If you have any questions, please contact Donald C. Berno, Legislative Counsel for our Small Business Center, 463-5503.

Sincerely,

Albert D. Bourland

cc: Committee Members
Leonard Weiss, Staff Director
Jo Anne Barnhart, Minority Staff Director



CMAA
CONSTRUCTION MANAGEMENT ASSOCIATION OF AMERICA

April 1, 1987

The Honorable John Glenn
Chairman, Committee on Government Affairs
United States Senate
Washington, D.C. 20510

RE: S. 328, The Prompt Payment Act Amendments of 1987

Dear Senator Glenn:

The Construction Management Association of America (CMAA) is pleased to join its colleague organizations comprising the Coalition for Prompt Pay in supporting passage of S. 328, The Prompt Payment Act Amendments of 1987. The Board of Directors, meeting on March 20, 1987, unanimously endorsed the bill on behalf of its membership of almost 700 firms and individuals practicing professional construction management throughout the United States.

Construction Management as a professional service has as its objective the control of time and costs in construction project delivery, while ensuring the quality of the project on behalf of the owner. We believe that timely payment for work performed by all contractors on a construction site, in both public and private sectors, is a critical factor in effective management of a project and in the avoidance of costly disputes. Construction Management functions on the principle of cooperative relationships among the parties on a project, and CMAA believes that S. 328 is constructive legislation that will benefit prime- and trade contractors and contribute to the effective application of that principle in our industry.

The construction industry as a whole has sometimes been characterized as riddled with disputes and inefficiencies brought on, at least in part, by the adversarial relationships that evolve among the parties on a project. These Amendments address a crucial element of the overall problem, prompt payment, the successful resolution of which will directly benefit government construction and set a positive example for the entire construction industry.

If there is any further way in which we may be of assistance to you or the co-sponsors of this bill, please let us know.

Yours sincerely,

CONSTRUCTION MANAGEMENT ASSOCIATION OF AMERICA

Karl F. Borgstrom
Executive Director

12355 SUNRISE VALLEY DRIVE • SUITE 640 • RESTON • VIRGINIA 22091 • (703) 391-1200

Contract Services Association

March 17, 1987

Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate
SD-340, Dirksen Office Building
Washington, DC 20510

Dear Senator Glenn:

The Contract Services Association (CSA) is the major trade association exclusively serving the companies which provide technical and support services to Federal agencies. CSA maintains a strong interest in all issues which affect our membership (list attached), including the timeliness of payment by the Government for services that have been performed and accepted.

CSA members have been concerned, for several years, over the manner in which the Prompt Payment Act has been implemented, which we do not feel is consistent with the Congressional intent in passing this legislation. We welcome this oversight hearing and the opportunity to submit our comments and recommendations, which we feel will support amendment of the Act to better serve the national interest and Congressional purpose.

When the Congress originally held hearings, and the General Accounting Office investigated the payment of invoices under Government contracts, there was ample evidence that entirely too often payment was delayed to an extent that a contractor, who had provided a product or service in a timely and satisfactory manner, suffered significant financial hardship. Small contractors were particularly hard hit when it was necessary to borrow money to continue operations, pending receipt of payment from the Government. Interest costs are not an allowable cost under Government contracts, of course, and it was for this reason that Congress passed the Prompt Payment Act, requiring payment of interest to the contractor whenever it takes more than 45 days to pay a proper invoice. The contract community applauded this legislation and looked forward to speedier payment or interest to offset the cost of money required to finance their Government contracts.

605 14th Street, N.W. • Suite 500 • Washington, D.C. 20005 • (202) 347-0600

When the Office of Management and Budget (OMB) Circular A-125 was issued to implement the provisions of the Prompt Payment Act, we were aghast to see a provision which stated that payment should not be made in less than 25 days! The directive which was to implement the Prompt Payment Act actually prohibited prompt payment! When Industry representatives protested this provision to OMB, they were told that payment of invoices in 30 days was "standard business practice" and "good cash management".

Mr. Chairman, I realize that the Defense industry is not as popular today as we would like and it may be difficult to engender a great deal of sympathy from the Congress or from the general public, which have been regaled with "horror stories" of fraud, waste, and abuse. Without opening up those issues and related half-truths, untruths, and innuendo, I would like to point out that those "horror stories", even if true, do not relate to the service contracting industry. Service contracting is highly competitive; profit margins are very thin, and are shaved even thinner by unallowable costs, unpaid receivables, increasing risks for liability and Government property, and the current drive to reduce average profit rates on Defense contracts.

Most of the costs incurred under service contracts are for direct labor, and employees insist on being paid regularly and promptly, regardless of when their employer is paid by the Government. Payrolls must be met on a weekly or bi-weekly basis and the contractor incurs considerable costs before completion of a billing period, which is normally one month. When the time necessary to document and audit the costs and submit a proper invoice are added, the contractor has carried this expense for at least 30 days before it is billed. If payment is delayed another 30 days, then the contractor must maintain an investment equal to 17-20% of the annual contract value throughout the year. This level of "Accounts Receivable" dilutes an otherwise favorable return on investment, which tends to compensate for the traditionally low return on sales and eliminates the incentive for companies to engage in service contracting with the Government. When responsible contractors abandon the Government service contract market, because of low returns, competition is decreased, prices will rise, and the Government and the taxpayers will suffer.

Prior to issuance of OMB Circular A-125, contractors were able, in many cases, to arrange for truly prompt payment of invoices, frequently 24 hours or less. Under direction from OMB, such arrangements are now proscribed and any agency which dares to pay an invoice in less than 25 days must report that transgression to OMB and provide an explanation. As a result, one of our member companies has reported a significant increase in Accounts Receivable since passage of the Prompt Payment Act and issuance of Circular A-125. The table below shows the average age of that company's receivables, by year:

Year	1980	1981	1982	1983	1984	1985	1986
Age (Days)	40.9	38.9	40.3	43.9	44.7	48.2	53.1

Analysis of these figures shows an increase in the average age of service contract receivables of 35%, primarily after passage of the Prompt Payment Act in 1982. We do not feel that this result reflects the intent of Congress in passing this legislation.

In regard to OMB's position that 30-day payment is "standard business practice", we agree. But so is the allowability of costs for contributions, advertising, interest, legislative liaison, and actual travel expenses (regardless of the limits placed on Government employees). These are normal costs of business and become losses for Government contractors which reduce apparent profit. If the Government were willing to adopt "standard business practices" across the board, Industry would be very happy to accept 30-day invoice payment. The selective application of those business practices which are adverse to the contractor's interests, however, is inequitable and indefensible.

There are other problems in the implementation of the Prompt Payment Act with which the Committee is very familiar - failure to start the 45-day clock when an invoice is submitted in accordance with the provisions of the contract, failure to pay interest when due, etc. The purpose of this submission is to ensure that you are aware of the OMB direction which establishes a minimum time for payment and converts the Prompt Payment Act into a Delayed Payment Act. We strongly recommend that the Act be amended to specifically state that agencies be encouraged to pay invoices, properly submitted after the product or service has been delivered and accepted, as expediently as possible, with no minimum time for payment.

Thank you very much for your consideration of our concerns and recommendations. Representatives of our Association would be happy to meet with you and members of your Committee or their staffs to discuss this problem further.

Sincerely,

W. D. Russell

William D. Russell
President

March 16, 1987
STATEMENT OF J. H. McQUISTON
on S. 328

McQuiston Associates
Los Angeles, California 90038

Mr Chairman and Members of the Committee:

McQuiston Associates is a "think tank" which is deeply involved with the Competition in Contracting Act and the Equal Access to Justice Act. Not only as a small business contracting with the United States, but also as a management consultant to other small businesses, McQuiston Associates has gained a lengthy experience in the contracting practices of federal agencies.

With that experience, I know that agencies do abuse their procurement powers over "weaker" parties with which they contract. I believe these tactics are more evil than when they were practiced by John D. Rockefeller in the Standard Oil Trust, because the United States by "commercial" actions must not do what it despises in other actors. Any federal agent which deliberately withholds capital rightly due another, no matter if withheld by Gramm-Rudman-Hollings, or the Anti-Deficiency Act, or just plain meanness, should be obliged like all others in commerce to pay as "rent" an amount specified by the person to whom the capital is due. Any departure from this concept is an unfair exercise of sovereign power which in 1976 Congress specifically barred from all other sovereigns. Congress should not be reasserting in S. 328 this unfair power.

Thus I strongly disagree with S. 328 as written. I pray that the Senate majority sponsoring this bill will realize that it really does not help its intended beneficiaries; rather, it leads them into a morass of debt. And S. 328 will surely drive undercapitalized businesses into bankruptcy.

Moreover, S. 328 is liable to injure the National Defense. Injury is because the Defense Production Act (DPA), 50 U.S.C.App §§2061 et seq, provides that no DPA contract will be mandatory, even if procurement is critical, if the contract's terms and conditions differ from the supplier's ordinary terms and conditions. See also 15 C.F.R. §350.13(c)(1). Because S. 328 prescribes terms which are dictated by the buyer, it defeats the DPA.

Furthermore, in the Paperwork Reduction Act Congress committed to reducing the burden of conducting business with federal agents. S. 328 violates the commitment, by requiring even occasional sellers to learn an entirely different way of protecting their capital together with a continuing demand to keep abreast of revisions in the outside chance that some federal agent may buy from them.

Even now, the FAR Council is considering permitting agents to withhold, per regulation, monies due occasional contractors even though the money withheld exceeds the entire net worth of the person owed the money. At the other extreme, a government official may demand,of any newspaper vendor or taxi driver, submission of an invoice and the subsequent right to withhold payment for 30 days thereafter. These abusive processes will not be controlled by S. 328; they are clearly intolerable.

These key defects mean that another approach is urgently needed.

RECOMMENDED MODIFICATIONS TO S. 328

I. Explicit "Commercial" Waiver

H. Rep 94-1487 & S. Rep 94-1310 explain why modern sovereigns do not exert sovereign powers in their commercial activities. The United States may also, for its commercial transactions, cast off the cloak of sovereignty, to keep the playing field level. This must be done with explicit language in a statute:

> "[T]here can be no consent by implication or by use of ambiguous language. * * * The consent necessary to waive the traditional immunity must be express, and it must be strictly construed." Library of Congress v Shaw, ___ U.S.___, 54 LW 4951 at 4954 (1986), citing prior S. Ct. cases

Then the courts will allow an injured federal contractor to recover interest for capital withheld beyond the due date:

> "The no-interest rule is similarly inapplicable where the Government has cast off the cloak of sovereignty and assumed the status of a private commercial enterprise." Shaw at 54 LW 4953 n.5

The United States already has had its immunity revoked abroad, where persons not U.S. citizens may collect interest for delays in payment. And in FSIA (P.L. 94-583), Congress explicitly cast off the cloaks of every foreign sovereign conducting commercial business in the United States (28 U.S.C. §1605(a)(2); §1606; §1607. It would be manifestly unfair to keep for itself what it denies to citizens, yet allows to foreigners and demands of all other sovereigns.

The applicable sections of FSIA have already been interpreted by the Judicial Branch (See, e.g, Verlinden v Central Bank of Nigeria, 103 S.Ct 1962 (1983)). Thus Congress can with confidence enact the sections proposed below, which echoes it:

Add to Titles 10 & 41

> "The United States shall not be immune from the jurisdiction of courts of the United States or of the States in any case in which the action is based upon a commercial activity involving an express or implied contract carried on in the United States by the United States; or upon an act performed in the United States in connection with a commercial activity involving an express or implied contract of the United States elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity involving an express or implied contract of the United States elsewhere and that act causes a direct effect in the United States.

> "As to any claim for relief with respect to which the United States is not entitled to immunity under this section, the United States shall be liable for its commercial activity involving an express or implied contract in the same manner and to the same extent as a private individual under like circumstances; but the United States except for an agency or instrumentality thereof shall not be liable for punitive damages; if, however, in any case brought under the law of contracts, the law of the place where the action or omission occurred provides, or has been construed to provide, for damages only punitive in nature, the United States shall be liable for actual or compensatory damages measured by the pecuniary injury resulting from such action or omission which was incurred by the persons for whose benefit the action was brought.
>
> "In any action brought by the United States, or in which the United States intervenes, in a court of the United States or of a State, the United States shall not be accorded immunity with respect to any counterclaim for which the United States would not be entitled to immunity under this section had such claim been brought in a separate action against the United States.
>
> "The purpose of this section is to assume for the United States the status of a private commercial enterprise with respect to its express and implied contracts in commerce."

The above language will forestall any serious allegation or defense that the statutes enabling collection of compensation for non-payment must be construed strictly, thus avoiding payment on account of "sovereign immunity".

The above language carefully limits the waiver, to those commercial acts which Congress is empowered by the Constitution to authorize. Thus with respect to acts which are conducted outside the law the United States will not be liable, but the agent which acted unlawfully in an official capacity will be liable instead. This separation is required because the Constitution gives limited power to the Executive and does not authorize the Executive to perform unlawful acts on behalf of the United States. See, e.g, S. Hrng 98-288 at 143-144.

Inasmuch as the language does not restrict the right of anyone except the United States, the language may take effect upon enactment and can be effective on all contracts in effect or being undertaken on the enactment date, without regard to the rights of contracting parties.

Liability for Interest

Releasing sovereign immunity makes authorizing the payment of interest quite simple. But a statute providing for payment of interest cannot refer to such as a "penalty" without rendering the amount virtually uncollectible. This is because sovereigns are not liable for "punitive" damages. Most courts of the United States construe penalties as "punitive", and payment will be avoided.

Modern society does not regard interest as punitive. It is "rent" paid for the use of someone else's capital. Statutes should not call it a "penalty".

However, the gravamen of S. 328 is *how much* "rent" should be paid. The actual *rate* is a measure of how *dearly* the person who *lends* the capital values its possession. A person *short* of capital will lend it *more* dearly than one not so constrained. And the borrower's option is *not to borrow* from the person.

A business from which the United States has "borrowed" capital by virtue of not paying a bill when due, must in turn borrow *other* capital to carry on in business despite the non-payment. But when *businesses* borrow, their lenders charge them a *higher* rate than what the United States pays. So, it is *unjust* for the United States to set the rate by which it will compensate forced lenders of capital.

To correct S. 328 we must adopt a marketplace attitude instead of the sovereign's viewpoint. The decision of *when* to repay an interest-bearing "loan" will depend on market factors, like competing interest rates and the need for more goods. The higher the supplier values its capital, the faster will be the payment. This is another reason why S. 328 should *not* set a uniform rate of payment for delays.

Even if the seller fails to set forth expressly the rate of interest, such rate can be easily imputed from the "discount for prompt payment". For example, terms of "1% 10 days, net 30 days" correspond to an interest rate of 1½% per 30 days. On the other hand, "Net 30 days, no discount" corresponds to an interest-free sale. Such terms will invite the longest delays.

It is clear that "terms" constitute another item to be evaluated in deciding which offer is the most advantageous to the United States. However, there is another complication if one evaluates offers, because a habitually-late payor likes *low* rates, while an early payor likes *high* rates (i.e, a large discount for prompt payment). A statute permitting selection on the basis of discounts must also in fairness segregate the two classes of payors.

Moreover, the agency is entitled to place a time-value on any capital that will be due from the vendor (fees, etc). The agency's time-value will not usually be the same as the vendor's. Nonetheless, each is entitled to know *exactly* what the other's time-rate will be, *before* entering into the contract. Thus a clause tying the rate to a future fixing is *not* adequate.

Lastly, payment for delay in a United States contract is an obligation of the United States and not of its agent. If the debt is denied, the Anti-Deficiency Act will operate to prevent any agent from paying, under pain of fine and prison. It is therefore useless for the Prompt Payment Act to bar appropriation of monies for delay. Such language makes the debt uncollectible.

The foregoing shape the following statutory sections into cohesion. And by placing more responsibility on the seller, the statutes are greatly simplified:

Amendments for Titles 10 & 41:

"Compensation for delayed payment. Every solicitation at any tier of the procurement chain connected to a commercial activity involving an express or implied contract with the United States or with any instrumentality or agency thereof shall provide a place for prospective offerors to state the terms of credit by which they usually do business, regarding the goods or services proposed to be purchased by the solicitation, and a place for the offeror to enter the terms of credit which the offeror requires as a condition of furnishing the goods or services in the offer. The offeror's terms of credit shall define what will be "delivery", the time when payment is due after "delivery", the discount offered for prompt payment and the time when the prompt-payment discount will become invalid, and the rate of interest (if any)-and any collection charge which will accrue for payment after the due date. If the offeror's terms of credit specify a discount for prompt payment, but fail to specify whether or not interest will be charged for late payment, an interest rate for late payment shall be imputed from the terms of prompt payment. If such imputation produces an ambiguity in the rate, the higher of the ambiguous rates shall be imputed.

"**Penalties.** Any person who induces any offeror not within the person's organization to propose to a United States contractor or subcontractor terms of credit which differ from those by which the offeror usually does business, shall, upon conviction, be fined not more than $25,000 or imprisoned not more than one year, or both. For the purposes of this section, "person" includes any government agency and any government employee.

"Compensation for overpayment. Every solicitation shall contain a clear statement accompanying the solicitation, which will set forth the charge and rate of interest, if any, on payments due the United States on account of any assessment or overpayment which may become due in the course of the contract which may result if the solicited offer is accepted by the United States. Such charges and rates shall be specific and shall not rely on any rate which is not set forth exactly in the statement, which shall form a part of any contract resulting from the solicitation. No other assessment by the United States shall be allowed as a part of the contract. Every charge and rate shall be numerically expressed.

"Amounts impounded or withheld. Any amount impounded or withheld by any United States agent, under any express or implied contract, shall be subject to interest from the date of impoundment or withholding to the date of release, at the rate specified by the offeror for late payments, or at the rate imputed from the offeror's discount for prompt payment if no rate for late payment was specified by the offeror.

"Terms of credit as evaluation factor. Competing offerors may be evaluated in part on the terms of credit they offer. However, no negotiator shall suggest to any offeror that the offeror's terms of credit should be adjusted as a condition of award, and such suggestion if made shall invoke the penalty specified by this section regardless of whether or not the offer is actually affected thereby.

"If over 95 percent of agency payments to contractors are paid with full discount properly taken, in the last publicly-reported period, then the agency may evaluate offers at the fully-discounted prices.

"If less than 85 percent of agency payments to contractors are paid "by the due date specified by the contracts, in the last publicly-reported period, then the agency may evaluate offers by increasing the undiscounted price by a multiplier derived from the interest rate of the offeror, the average delay in payment, and the probability of lateness (equal to the fraction of late payments)."

These amendments do not infringe on rights of private parties, except for the "Penalties" section, so they can be effective on enactment. The "Penalties" section must only be applied to contracts begun after the effective date.

Amendments for Title 31

Amend §3901(a)(3) to read:

"(3) "proper invoice" is the regular invoice of the contractor, accompanied with proof of "delivery" as specified in the contract."

Amend §3901(a)(4) to read:

"(4) the United States is deemed to receive a proper invoice--

(A) if mailed in the United States Postal Service, on the fifth day after the date of mailing;

(B) if not mailed in the United States Postal Service, on the day of receipt by the officer receiving correspondence from without the agency contractually obliged to receive proper invoices."

Amend §3901(a)(5) to read:

"(5) a payment is deemed to be made on the fifth day after the date of mailing, if payment is mailed in the United States Postal Service, or on the date the payment is delivered to the payee, if payment is not mailed in the United States Postal Service."

Add to §3901(a) the following:

"(7) "delivery" is deemed to be defined per the contractor's terms of credit as set forth in the contract. If the terms of credit do not unambiguously determine "delivery", the following may be used as imputed:

"(A) Contracts prescribing acceptance at origin: Goods or services are "delivered" upon proof either of shipment from origin or of acceptance or receipt by an authorized agent or instrumentality of the United States within the origin.

"(B) Contracts prescribing acceptance at destination: If the goods or services are shipped----

i via the United States Postal Service, there is an irrebuttable presumption that the goods or services were "delivered" five days after the date of postmark of the shipment.

ii via common carrier, there is a rebuttable presumption that the goods or services were "delivered" five days after the date of receipt by the common carrier.

iii via other means, there is an irrebuttable presumption that the goods or services were "delivered" on the day of receipt by the officer receiving goods or services from without the agency contractually obliged to receive the goods or services."

Amend §3901(b) to read:

"(b) Unless specifically prescribed otherwise in this chapter, each independent agency and instrumentality may adopt regulations, which differ from those set forth in this Chapter for agencies whose regulations are to be prescribed uniformly, to carry out the duties imposed by this Chapter."

Add §3901(c) to read:

"(c) Section 3906 of this title shall not apply to any independent agency or instrumentality which is not otherwise subject to the Contract Disputes Act."

Amend the catchline of §3902 to read "Compensation for Delayed Payment".

Amend §3902(a) to read:

"(a) Payment of proper invoices received pursuant to express and implied contracts for goods and services shall be in accordance with the terms of credit as specified by the contractor in the contract. If payment will not be made before the due date specified by the contractor for discount, no discount shall be taken. If payment will not be made before the due date specified by the contractor for payment, compensation for delayed payment shall be paid in accordance with the contract, in the amounts either specified by the contractor or imputed from the discount terms."

Amend §3902(b) to read:

"(b)(1) Any amount of compensation for delayed payment shall be paid without regard to whether or not the payee has requested payment thereof.

"(2) Non-payment of compensation for late payment, or subtraction of prompt payment discount when not entitled thereto, shall entitle the payee, additionally for each occurrence, to the larger of--

(A) the collection fee set forth in the contractor's terms of credit; or

(B) a sum of 5 percent of the erroneous payment, or $100, whichever is less."

Amend §3902(c) to read:

"(c) Unless otherwise specified in the contractor's terms of sale, any amounts due the contractor on account of goods or services delivered which are past due shall be added to the principal amount of the debt periodically in the same manner as the contract specifies for overpayments or amounts due the United States."

Amend §3902(d) to read:

"(d) Amounts payable as compensation for late payment or non-payment of compensation for late payment are authorized to be paid out of the general appropriation for the payor."

Amend §3902(e) to read:

"(e) Repealed."

Amend §3903 to read:

"The Director of the Office of Management and Budget shall prescribe regulations to carry out this subchapter uniformly within all agencies not otherwise entitled to prescribe regulations independently. No payment regulation of any United States agent or instrumentality shall permit the time of delivery or the time of receipt of a proper invoice to be determined unilaterally by the payor, but shall prescribe for immediate notification of the contractor upon discovery of any perceived defect in an otherwise proper invoice and for telephonic supplementation to cure the perceived defect."

Amend §3904 to read: "Repealed."
Amend §3906(a) by adding before the period ", or other applicable laws as applicable"
Amend §3906 (b) & (c) to read: "Repealed".

These amendments can be effective on all contracts pending after the effective date, except for solicitations conducted under prior versions of the Prompt Payment Act in which the rate within the Act would be higher than the rate authorized by these amendments. For those few contracts a saving clause may be in order.

These statutory modifications eliminate the stain of sovereignty which have permeated the Prompt Payment Act and have created the payment problems. Importantly, the amendments remove the despicable double standard from United States contracts, put the contractor properly in control of its own destiny, preserve the full force of the Defense Production Act, and permit full competition with respect to terms of credit. Nothing could be more equitable.

I believe this Committee will welcome these amendments to S. 328. And I will assist the Committee in any way necessary to implement them. They are sorely needed.

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STATEMENT
TO THE
GOVERNMENTAL AFFAIRS COMMITTEE
UNITED STATES SENATE
ON
S.328
PROMPT PAYMENT AMENDMENTS OF 1987

Submitted by the
Mechanical Contractors Association of America, Inc.
Thursday, March 19, 1987

Subsidiaries include: National Certified Pipe Welding Bureau, National Mechanical Equipment Service and Maintenance Bureau and National Environmental Balancing Bureau.

Mr. Chairman and Members of the Committee:

The Mechanical Contractors Association of America, or MCAA, is proud to submit this statement in support of S.328, the Prompt Payment Amendments of 1987.

MCAA is a construction trade association of about 1,300 firms, employing approximately 125,000 persons. The work of a mechanical contractor is used to move fluids -- both liquids and gas. This includes the fabrication and installation of heating, ventilating, air conditioning and process piping systems, and further encompasses service, maintenance and the testing, adjusting and balancing of these systems. Our work effects multi-residential, commercial, public and industrial facilities. Nearly all (96 percent) of our members work in the private sector of the construction market, with 70 percent working in the state and local marketplace. About one-half perform federal contract work -- most as subcontractors.

To our members, business is a two-way street -- be it a government agency, a contractor, or a subcontractor.

In 1982, Congress passed the Prompt Payment Act to ensure that government would pay its contractors on time. The Act imposed time limits upon the government for making payments and assesed late payment interest penalties when it failed to meet these deadlines.

The Prompt Payment Amendments of 1987 (S.328) would take that legislation one step further by requiring government construction contractors to include prompt payment provisions in their subcontracts and purchase orders in accordance with prevailing industry standards. It would also require the payment of late payment interest penalties when these provisions were not met.

Section 7 of the current Senate amendments to S.328 includes language which would provide this flow-through of prompt payment benefits to subcontractors. While the passage does not address the area of Federally-assisted contracts, it is MCAA's sincere hope that the subcontractors who fall under that category could also benefit from this legislation.

Like the federal contractors who benefited from prompt pay back in 1982, MCAA members who subcontract on government projects also have businesses to run and payrolls to meet. The cycle does not stop with the contractor. MCAA joins the Associated Specialty Contractors (ASC), the Coalition for Prompt Pay, and the American Subcontractors Association (ASA) in supporting S.328 and completing the cycle of prompt pay.

MBELDEF
Minority Business Enterprise Legal Defense
and Education Fund, Inc.

Statement of

THE MINORITY BUSINESS ENTERPRISE LEGAL DEFENSE AND EDUCATION FUND, INC.

to the

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

in support of

S. 328

PROMPT PAYMENT ACT AMENDMENTS OF 1987

March 19, 1987

Parren J. Mitchell
Founder and Chairman

318 Massachusetts Avenue, N.E.
Washington, D.C. 20002
202/543-0040

Anthony W. Robinson, Esq.
President

MBELDEF
**Minority Business Enterprise Legal Defense
and Education Fund, Inc.**

Statement of

S. 328, Prompt Payment Act Amendments of 1987

The Minority Business Enterprise Legal Defense and Education Fund is a non-profit public interest law firm that serves as the national legal advocate on behalf of the minority business community. In our capacity as champions of legal causes for minority businesses, we are frequently confronted with cases that involve federal contracting issues. One of the most frequent complaints we receive from minority contractors involves late payment and non-payment by prime contractors in the construction industry. Herein lies our interest in supporting Senate Bill 328, the Prompt Payment Act Amendments of 1987.

Our experience with complaints from minority-owned government contractors and subcontractors indicates that Section 7 of S. 328 is desperately needed. We are aware of several instances in the construction industry where the failure of prime contractors to pay minority sub-contractors in a timely fashion has resulted in their economic ruin.

Parren J. Mitchell
Founder and Chairman

318 Massachusetts Avenue, N.E.
Washington, D.C. 20002
202/543-0040

Anthony W. Robinson, Esq.
President

An all-too-typical scenario is emerging across the country wherein a prime contractor reluctantly subcontracts to a minority-owned firm in order to comply with a federal goal. Even though that subcontractor satisfactorily completes a portion of a project, the prime contractor refuses to pay the subcontractor progress payments on the false pretense that the prime has not yet been paid by the government. After several months, the subcontractor is effectively forced to continue work on the project without payment, or risk default. The subcontractor's cash flow is seriously disrupted. As a result, sometimes subcontractors fall behind in payroll tax payments, causing serious difficulties with the IRS. In other instances, the prime contractor contacts the subcontractor's suppliers and urges them to file claims against the subcontractor in order to ensure payment. When this occurs, the prime contractor is relieved of its obligation to pay the subcontractor pending resolution of the claims, even though the prime contractor's failure to pay the subcontractor is the underlying cause for the subcontractor's weakened financial condition. For minority contractors, these tactics are tantamount economic lynching.

Although the phenomenon can certainly occur with all subcontractors, we believe its impact is especially devastating to the class of minority subcontractors that we represent. Typically they are economically disadvantaged and do not have the financial wherewithal to protect their interests in the courts. This precarious financial condition is further exacerbated by late payments from prime contractors. Unscrupulous prime contractors purposely string along such subcontractors because they are aware of their inability to fight back. In several instances, minority subcontractors have been forced to accept partial payments of 50% or less of what they are actually owed in order to avoid bankruptcy.

In our view, Section 7 of S. 328 is an important step in the right direction to remedy these kinds of abuses. The government's interest in seeing that its subcontractors are paid in a timely fashion is identical to its interest in insuring prompt payment to its prime contractors. The financial stability of countless small businesses are at stake, and directly tied to that financial stabilty are thousands of jobs. Moreover, at a time when this government ostensibly has a policy of fostering the growth of minority businesses through increased opportunities in federal contracts, it would be the cruelest of hoaxes for the federal government to permit this kind of economic strangulation to continue in its own back yard.

This problem is so pervasive that additional modifications beyond S. 328 may ultimately be required to provide a complete remedy in other areas of federal construction. We understand, for example, that this bill does not apply to highway construction, where some of the greatest abuses are taking place. Nevertheless, at the very least, we urge the passage of S. 328 with Section 7 intact as an important first step.

Respectfully submitted,

Anthony W. Robinson
President
MBELDEF

NACM

NATIONAL ASSOCIATION OF CREDIT MANAGEMENT

520 Eighth Avenue
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(212) 947-5070

March 17, 1987

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the National Association of Credit Management (NACM), I want to commend you and the members of the Committee on Governmental Affairs for your prompt attention to S. 328, the Prompt Payment Act Amendments of 1987. I understand that this legislation, which was introduced by the distinguished senior Senator from Tennesse, Mr. Sasser, and cosponsored by more than half the Senate, will be the subject of a hearing before the full Committee on Thursday, March 19, 1987.

As you may know, NACM is an association of approximately 42,000 business credit executives from manufacturing, wholesaling, service industries and financial institutions. In this capacity, NACM represents 95 per cent of the Fortune 500; however, the vast majority of our members are small businesses. There also are 72 regional associations which serve the membership.

As an association, NACM seeks to promote honesty and fair exchanges of business credit information; sound laws for good credit; training opportunities for business credit grantors to improve their knowledge and efficiency; and facilities for the investigation and prevention of fraud which is so harmful to many businesses and individuals.

As individuals, NACM members manage the second largest current asset on the nation's balance sheet -- accounts receivable. Our members are therefore in a unique position to know and appreciate first hand the importance of the timely payment of invoices, as well as the critical impact that delays can have on the economy. Perhaps nowhere is this impact felt more adversely than in the small business sector.

NACM is therefore proud to have been a strong supporter of the original 1982 Prompt Payment legislation, and continues to urge that all Federal agencies be made to faithfully comply with this important law.

Unfortunately, NACM believes that more than encouragement by the private sector is required at this point. Despite representations to the Congress by the Office of Management and Budget that Federal agencies are overwhelmingly in compliance with the law's requirements, our membership's actual experience has often been to the contrary. Hearings before this Committee and the Senate Small Business Committee in the last Congress have adequately documented this fact, as has the report issued by the General Accounting Office last summer.

Legislation is clearly needed in order to assure the important benefits that the original Prompt Pay Act was intended to provide, not just to the private sector, but to the Federal government itself. As we have noted in the past, to the extent the Federal government's bad payment practices discourage many businesses from dealing with the government in the first place, these practices thereby reduce the longterm savings to the government that are among the benefits of a competitively healthy marketplace.

NACM is therefore delighted to see your Committee's speedy consideration of S. 328. We understand that this legislation is essentially identical to S. 2479, Senator Trible's excellent effort which was approved by the Senate in the 99th Congress with our strong support. In this regard, we would like to draw to your attention the important compromise that last year's measure presented with regard to the question of timely payment of subcontractors by Federal prime contractors.

Many of NACM's members often serve as subcontractors and suppliers for Federal contractors, while many of our members are themselves Federal prime contractors. Clearly, the issue of timely payment is of interest to all our membership, and we believe that the approach contained in S. 328 to assure this common goal for all parties concerned is an important element of the overall legislation.

NACM firmly believes that the business of government should be conducted in a sound, businesslike fashion in order to set an example for the rest of the economy to follow; Federal procuring agencies should provide role models, not case studies for oversight hearings.

Once again, NACM congratulates you and your colleagues for your dedication to improving the Prompt Payment Act. If we can be of any assistance in this measure's prompt progress toward public law, please feel free to call on me or our Washington representative, David Vienna & Associates (202-547-0440). We would also like to request that this letter be made a part of the hearing record on S. 328.

Sincerely,

Robert A. Johnston
Executive Vice President

NAMC
NATIONAL ASSOCIATION OF MINORITY CONTRACTORS
806 15th Street, N.W. • Suite 340 • Washington, D.C. 20005 • (202) 347-8259

April 27, 1987

The Honorable John Glenn
United States Senator
Chairman, Committee on Governmental Affairs
SD-340 Dirksen Senate Office Building
Washington, D.C. 20510

Re: S. 328 - Prompt Pay Act Amendments of 1987

Dear Senator Glenn:

As the national representative of nearly 60,000 minority construction contractors in America, the National Association of Minority Contractors (NAMC) strongly supports the Prompt Pay Act Amendments of 1987, particularly the provision requiring prime government construction contractors to pay their subcontractors on a timely basis.

Nationally-attended public hearings held by NAMC during the past year in Florida, Massachusetts, California and Nevada clearly demonstrated that late payments by prime contractors to minority subcontractors is not only rampant in the construction industry but it also appears that such tactics have been used to purposely cripple minority construction firms or otherwise put them out of business.

Many prime contractors take such action in defiant retaliation to legislation requiring them to utilize a certain percentage of minority subcontractors. Unscrupulous prime contractors realize that most minority subcontractors cannot afford to take them to court. Thus, in many instances, minority subcontractors are forced to accept 50% or less of what they are actually owed. This tactic has led to a virtual economic strangulation of countless minority contractors.

It has been argued that the relationship between the prime contractor and the subcontractor is private and the government should not get involved. However, where public contracts, and thus taxpayer funds, are involved the federal government has a compelling interest to ensure that subcontractors are promptly paid. Of even more importance is the government's interest in making sure that federal laws requiring minority business utilization are not undermined by intentional acts of late and/or lack of payment to minority businesses. The government should always intervene in the private industry through legislation when market factors cannot in and of themselves dictate business fairness among private parties.

The proposed legislation which requires prompt payment by primes to subs should be avidly supported and promptly enacted.

Very truly yours,

Ralph C. Thomas III

Ralph C. Thomas, III
Executive Director

RCT:dee

cc: Members of Governmental Affairs Committee

Senator Lawton Chiles
Senator Sam Nunn
Senator Carl Levin
Senator Jim Sasser
Senator David Pryor
Senator George J. Mitchell
Senator Jeff Bingaman
Senator Ted Stevens
Senator William S. Cohen
Senator Warren B. Rudman
Senator John Heinz
Senator Paul Trible

PHCC

National Association of Plumbing-Heating-Cooling Contractors
Pride In Our Past—Faith In Our Future

STATEMENT
TO THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
ON
S. 328
PROMPT PAYMENT ACT AMENDMENTS OF 1987

on behalf of the
National Association of Plumbing-Heating-Cooling Contractors

March 19, 1987

180 S. Washington St., P.O. Box 6808, Falls Church, VA 22046-1148 • 703/237-8100

Mr. Chairman,

The National Association of Plumbing-Heating-Cooling Contractors (NAPHCC) supports improvements to the Prompt Pay law. Congress should close existing loopholes and extend coverage of the act to the providers of goods and services as a result of federal involvement, but who may not have a direct relationship with the government.

The National Association of Plumbing-Heating-Cooling Contractors is the oldest national association in the construction industry and the largest plumbing and mechanical-subcontractor association. We have more than 6,000 members. Membership comes from every state in the country and is organized through about 300 state and local affiliated associations. This industry employs over 510,000 people and has receipts of 32 billion dollars.

We are disappointed that the committee did not permit us to give verbal testimony on the problems of Prompt Pay under federally assisted activities. Unfortunately, some organizations have preferred to continue to fan flames of controversy over the flow through of payment to subcontractors. As a result of this single issue focus, there has been insufficient willingness to consider other significant issues involved with getting small business paid promptly.

Fortunately, the Coalition for Prompt Pay has provided an excellent analysis. The Coalition has provided documentation for those issues that are being addressed, identified problems not yet addressed, and offered proposed solutions to these issues.

NAPHCC has continued to be concerned with the way in which the federal government pays its bills. Thus, we actively supported passage of the Prompt Pay Act of 1982.

However, experience with the law indicates that loopholes must be closed and the act must be extended. This is supported by the 1986 White House Conference on Small Business which included improvements to the Prompt Pay law among its top recommendations. (Attachment A)

While progress has been made on prompt payment policies, they stop short of providing the full measure of equal treatment that they should provide. This is particularly true for subcontractors and for federally-assisted jobs funded through grants, loans, mortgage insurance and other assistance. These jobs should rightfully be entitled to full and prompt payment of both progress payments and final payments.

To send that message to the administration, we supported Prompt Pay Improvements (S.2479) which passed the Senate last year. That's al[illegible] why we appreciate the sponsorship by members of this committee of legislation (S.328) this year. This bill is an important first step. However, we strongly believe some additional improvement must be made in the bill to correct critical payment problems.

It is imperative that you expand the policy to insure that payments flow through the system. There are many companies who provide the goods and services which enable prime contractors, grantees, and loan recipients, etc. to fulfill their obligations with the federal government. Just as small business cash flow and economic survival can be critically injured by slow pay in direct relationships with the government, so also can they be hurt when they provide goods and services through intermediaries.

NEED FOR FULL AND PROMPT PAY

Prompt payment is important because it saves money. It saves the government money which really means it saves you and me, the taxpayers.

Prompt payment saves the taxpayers' money in two ways...through lower more competitive prices and through increased productivity.

Slow pay can seriously undermine productivity and drive up costs to the taxpayer. A major problem in construction is proper scheduling. If materials are not on the job site, construction is delayed. Contractors delay ordering materials because of slow pay. When they do so, some materials may not be available. If materials aren't present, scheduling is delayed, workers are idle or laid off and productivity is lost.

Furthermore, 12 month projects that stretch out to 16 months mean 4 more months of overhead. There's more overhead costs for the contractor and for the developer.

Small businesses cannot finance their work as well as larger firms. They buy materials when they need them and expect to be paid for them. Frequently, these are purchased across the counter at higher prices. These higher costs are included in the contract price.

With slow pay, the prime contractor has trouble keeping subs on a project. If a subcontractor runs out of payroll money because of slow payment, he lays people off. When payments come through, he hires new people. However, these people are unfamiliar with the project and must learn its requirements. Loss of productivity can jump up to 25 or 30 percent.

There are estimates that our infrastructure needs are $3 billion to rebuild highways, bridges, dams. Labor alone is one-third or more of the projects. The average loss of time on a project is 29 percent and up to 54 percent on big projects. This is lost productivity which prompt pay could reduce. Using the more conservative 29 percent factor for lost time and eliminate it, we would save $300 million of the taxpayers money.

Prompt Pay requirements provide a system that will attract the largest number of businesses into government contracting, encourage the greatest amount of competition, an promote the lowest possible prices paid for government supported activities.

Requiring prompt payment is nothing new to the private sector marketplace. It simply extends the principles employed in the private sector marketplace to those activities financially supported by the federal government. The result is that prompt payment makes the government a more efficient, reliable business partner.

However, there's one more reason why the government should require prompt payment. It's right.

The federal government has a responsibility to the taxpayers and to its contractors to see that its money is being used right. That includes seeing that the flow through to the subcontractors who do the work and that includes seeing that government supported activities are properly managed.

We have several specific recommendations for improvement of the Prompt Pay Act.

PROMPT PAYMENT ON FEDERALLY ASSISTED WORK

Frequently, delays in payment are reported on federally assisted work performed through grants, loans, loan guarantees and mortgage insurance. Just as the current law requires prompt payment on direct federal work, it is essential that the federally assisted route should also encourage quick payment to those who perform the work.

When contractors complete their work, or a portion of it, they certify its completion and request payment. While certainly inspection of the job may be necessary to assure that the certification is accurate, it should be done promptly. There should be no excuses for tying up payment in the bureaucracy. It is in the best interests of the federal government to insure that payments on federally assisted activities are made promptly. It protects the investment by the federal government in the project.

Just as there were prior to enactment of the Prompt Pay Act, there will be cries that the process can't work that quickly and that interest penalties will hamper the work of those receiving federal assistance. However, with the force of the law requiring prompt payment or interest payments on late payments, federal agencies were able to comply far more effectively than their dire predictions. We believe that payments through federally assisted programs can likewise be jarred to greater efficiency, when there is a legal incentive.

Furthermore, extension of the Prompt Pay law is consistent with the spirit of the law. The law was enacted to insure that those businesses, and particularly small businesses, receive payments due to them in a timely fashion.

Congress first considered inclusion of federally assisted activities prior to enactment of the 1982 law. In the interest of getting prompt pay in place in the federal systems, the provisions for federally assisted activities were set aside for a later date. With the great success the prompt pay law has had, that time has come.

All to frequently, construction contractors face late progress payments and final payments for their completed work. The most notable and severe problems have been documented in NAPHCC surveys on mortgage insurance programs backed by the Department of Housing and Urban Development (HUD).

A survey by NAPHCC of contractors who do HUD work indicates that 15% of progress payments are paid more than 60 days late and an astounding 71% of final payments are paid later than 90 days. (Survey results are Attachment B.) Frequent reports have been received from contractors that they have not been paid final payment more than a year after completion and long after residents have moved into the HUD backed projects.

NAPHCC members on federally assisted jobs have been told by HUD that the agency has no control and cannot dictate the terms of a contract yet the federal officials freely admit that terms are dictated by federal regulations. For example, a May 15, 1986, letter from HUD to NAPHCC states, "None of the terms of the contract negotiated between a subcontractor and general contractor are dictated by HUD." (Letter from HUD is Attachment C.)

However, despite this assertion, a substantial number of contract provisions are required. These include affirmative action requirements, Davis-Bacon minimum wage requirements, etc. HUD regulations incorporate OMB Circulars A-102 (Uniform Requirements For Assistance to State and Local Governments) and A-110 (Grants and Agreements with Institutions of Higher Education, Hospitals, and other Non-profit Organizations). Attached to our statement are excerpts from HUD-5370, the general conditions of contract which include provisions for subcontracts. (Attachment D)

HUD officials have suggested to our members that we need not bid on work if we don't like the contract terms. They seem to forget the "golden rule" in construction that "He who has the gold, has the rule." Once the prime contractor has the contract, he can dictate terms to subcontractors through this subcontract agreements.

Some of those same officials have even suggested that subcontractors could jointly agree not to bid jobs where subcontractor payment terms are not acceptable. They completely overlook antitrust laws which prohibit such joint economic action. Thus, subcontractors hands are tied behind our backs by the antitrust laws while being told by HUD that we can resist prime contractor demands and payment terms for subcontract work.

The solution we propose to these severe payment problems is to extend the

Prompt Payment Act to federally assisted activities. Attached to our statement is a proposed section that could be added to the bill on "Requirements for Federally Assisted Activities." (Attachment E)

FINAL PAYMENT

Final payments on construction work continue to experience major delays. This is especially true of federally assisted HUD work which is backed by federal mortgage insurance. Frequently, these are larger payments incorporating retainage that may have been withheld through the course of the job. It is not unusual for a contractor to have completed a job and see the project in use while the contractor continues to wait for final payment.

Final payments, including retainage, should be paid promptly and on a line item basis to subcontractors upon substantial completion of their work. This involves redefining the starting point of construction completion from which interest will accrue. Where sums have been retained for punch list items, the amount retained should be no more than the value of the punch list items and then released when the items have been completed.

If final payment is not immediately forthcoming to the contractor or subcontractor for work substantially completed, funds due to the contractor should be placed in an interest earning escrow account to be released as soon as practical. Attached to our testimony is a proposed amendment to Section 5 of the bill which would accomplish this. (Attachment F)

FLOW THROUGH PAYMENTS AND INTEREST TO SUBCONTRACTORS

In surveys of members of NAPHCC who perform work for the federal government, it is not unusual to find payment delays in excess of the 30 to 45 day cycle which is customary in the construction industry. Many of these payments past through intermediaries. While this may contribute to some minimal delay, the record of longer delays indicates more severe problems with payments being delayed in the process.

If the federal government has delayed the payment, then the Prompt Pay Act applies and interest penalties are due. This interest should be passed on to the subcontractor who did the work. If the prime contractor has delayed payment, he should be liable for interest. It is in the best interest of the federal government to have prime contractors pay their subcontractors promptly to avoid delays on the project and promote timely completion. Federal policy requiring both prompt payment and interest on late payments will encourage quick completion and fair treatment to all participants in the project. Attached to our statement are reports from subcontractors who experienced payment delays from prime contractors. (Attachment G)

Contrary to assertions that have been made, requiring flow through of payments to subcontractors does not unduly infringe on the privity of contractor between the prime and the subcontractor. There are numberous provisions from the Federal Acquisition Regulations which primes must pass through to subcontractors (Attachment H). Recipients of federal assistance must pass many of these through as well.

PROMPT PAYMENT OF PROGRESS PAYMENTS

When the Prompt Payment Act was passed, the construction industry concluded from the language and legislative history that the requirement that the government pay its bills on time or pay interest would apply to construction work. Construction projects frequently require contracts that extend over many months under which progress payments are made for construction work completed.

Until recently, in narrow interpretations of the Act, federal agencies had determined that progress payments were for financing purposes rather than for work completed. In so doing, they had excluded the construction industry form coverage by the Prompt Payment Act because the Act does not cover payments for financing purposes. Attached to our statement is an exchange of correspondence relative to one such contract and the response from the General Services Administration that payments were for financing purposes. (Attachment I)

A recent OMB change makes partial payments for work completed eligible under the Prompt Payment Act. This has provided some relief for many construction payments. However, there still appear to be discrepancies in federal agencies over whether the act applies to progress payments.

Moreover, contracts financed with federal funds, such as grants and loans still produce late payments to small businesses. Frequently, we have been receiving reports of late payment of progress payments by construction industry contractors. This problem is further complicated because payment must first be made to the prime contractor who then uses the proceeds to pay subcontractors, and they in turn their second tier subcontractors, suppliers, etc. It is not unusual for some subcontractors to receive payments months or even years after work has been completed.

The Prompt Payment Act was intended to assist small businesses in getting timely payment from the government so that they could maintain themselves as viable economic entities with the ability to compete in the marketplace.
The complete beneficial effect cannot be felt until the same principles for fair treatment are extended to projects supported by the federal government.

CONCLUSION

The Prompt Payment Act was intended to assist small businesses in getting timely payment from the government so that they could maintain themselves as viable economic entities with the ability to compete in the marketplace. The complete beneficial effect cannot be felt until the same principles for fair treatment are extended to subcontractors and to projects supported by the federal government.

As plumbing-heating-cooling contractors, our members must commit for materials and provide labor on jobs. Scheduling and productivity can significantly increase or decrease depending on how fast we are paid. Prompt payment can reduce scheduling delays and increase productivity.

We are indeed pleased that the Congress is examining implementation of the Prompt Pay Act. The Senate legislation corrects several deficiencies, but should be expanded.

Our testimony addresses problems that are experienced in he construction industry. We support provisions in the bill which require flow through to subcontractors and which clarify congressional intent that the prompt pay law applies to construction progress payments. We also support closing loopholes in the law which are addressed by the coalition for Prompt Pay.

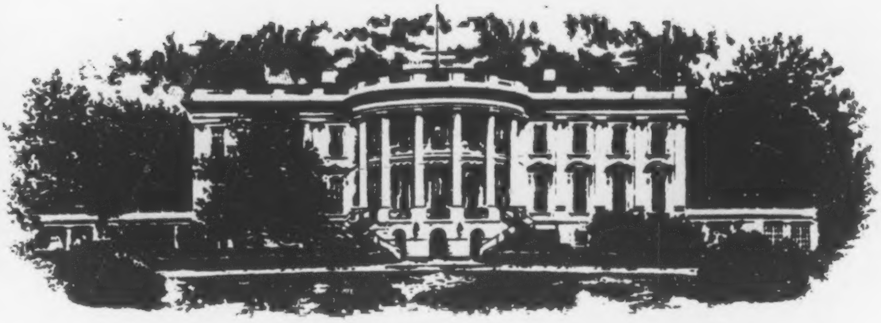
S.328 is an important first step to fine tuning the spirit and intent of the Act by addressing continuing problems which small businesses face in getting paid promptly.

However, as you review the legislation, we urge you to amend S. 328 and incorporate recommendations for extending prompt payment to federally assisted work and defining the start date for final payment.

Thank you for providing this opportunity to share the views of the National Association of Plumbing-Heating-Cooling Contractors.

DL/jat/3028G

ATTACHMENT A



THE WHITE HOUSE
Conference on Small Business

AUGUST 17 - 21, 1986

Prompt pay legislation should be extended to cover postal service and federally assisted procurement and strengthened through an amendment to the 1982 Prompt Payment Act to eliminate the fifteen day grace period; require automatic payment of interest penalties; more clearly define that the entire payment process, including acceptance, must occur within 30 days; include progress payments and retainage; and require prime contractors to pay their sub-contractors within seven days after receiving payment from the government or incur interest payment penalties. In addition, when the government pays the prime contractors late, interest payments shall flow through from prime contractors to sub-contractors on a pro-rata basis. The prompt payment act shall vigorously enforced by all branches of government.

ATTACHMENT 8

SEVERE PAYMENT DELAYS ON HUD CONTRACTS

Following are results of a survey of members of the National Association of Plumbing-Heating-Cooling Contractors (NAPHCC) who do federal work for the Department of Housing and Urban Development. The survey was conducted during the summer of 1985.

Approximately 700 surveys were sent to the network of contractors who perform HUD work. Of those, 85 were returned indicating they no longer do HUD work.

There were 87 usable responses by contractors who continue to perform work for HUD either through direct contracts or subcontracts with HUD or through federally assisted jobs.

26	Do primarily service work and/or small contracts
41	Do large jobs
20	Type of work not provided
87	Total responses

Generally, those who do service work and small contracts are satisfied. There was almost never retainage held and payment averaged 31 to 45 days. Contractors were generally satisfied with their HUD office and personnel.

For contractors who perform large jobs, HUD treatment was outrageous.

A) Retainage was almost always held at 10 percent. Final payment may take up to 15 months (Federal policy on direct federal construction indicates retainage should not be withheld routinely, but on a case by case basis.)

B) Median time for payment was 46 to 60 days days with several contractors reporting that payment took over 90 days.

C) The biggest problem cited was slow payment on progress payments and retainage. Two other major problems were paperwork and slow decision making.

Length of Time for NAPHCC Contractors to Get Paid

	Progress Payments	Final Payments
30 days or less	27%	-
31-45 days	32	7%
46-60 days	23	11
61-90 days	10	11
more than 90 days	5	71

DL/jat/3001G

ATTACHMENT ~~C~~

OFFICE OF THE ASSISTANT SECRETARY FOR
HOUSING-FEDERAL HOUSING COMMISSIONER

MAY 15 [illegible]

[illegible] 21 [illegible] CO

Mr. Dennis Lavellee, CAE
Director of Government Affairs
National Association of Plumbing,
Heating-Cooling Contractors
180 S. Washington Street
Falls Church, VA 22046

Dear Mr. Lavellee:

This is in response to your January 20, 1986 letter to Silvio J. DeBartolomeis, former Deputy Assistant Secretary for Multifamily Housing Programs, concerning the retainage of a percentage of construction progress payments and prompt payment of vouchers.

We assume that the situations you describe are not occurring under direct HUD contracts. The Federal Acquisition Regulation (FAR) provides for a flexible policy regarding the 10 percent withholding of construction progress payment and we encourage our contracting officers to recognize satisfactory performance and permit the waiver of any payment withholding on a case-by-case basis.

HUD's contracting officers are also expected to be very sensitive to the requirements of the Prompt Payment Act. Late payments are sometimes made, but they are closely monitored. As for payments of penalties associated with the 10 percent progress payment withholding, penalties could only be paid for properly billed amounts covering acceptable, completed work. The Prompt Payment Act is not applicable to subcontractors; therefore, unless the FAR is legislatively changed, the prompt payment provisions do not "flow thru" to subcontractors.

Provisions applicable to retainage of progress payment and prompt payments during, and upon completion of, construction differ when HUD is the mortgage insurer or lender in lieu of the contracting agent.

On projects receiving insurance of construction advances and projects with direct loans from HUD, Federal Regulations require a 10 percent retainage from construction progress payments. This retainage is normally held until construction is complete and the general contractor and mortgagor complete their cost certifications and take other necessary steps to permit final endorsement. When the general contractor's performance warrants, HUD Field Office Managers may release 50 percent of the holdback provided that construction has reached 90 percent completion. An authorization of additional releases can be obtained with the written consent of the surety and the Office Manager's assurance that failure to do so would probably result in a default of the construction loan.

ATTACHMENT C
Continued

2

HUD Field Offices are expected to place priorities on processing contractor's requisitions. These funds are released by the mortgagee to the mortgagor in projects involving mortgage insurance and by HUD through the Treasury Department to a depository and then to the Borrower in Section 202 projects for payments to general contractors and for other related costs. The Department relies on certifications by the mortgagor and general contractor that appropriate employees have been paid.

None of the terms of the contract negotiated between a subcontractor and general contractor are dictated by HUD. It is incumbent upon the subcontractor to protect itself in the event it does not receive its payments in accordance with the terms of its contract. Although we cannot assume the role of protector of subcontractors, where there is evidence of continued slow payment or nonpayment of subcontractors such that the mortgage security is jeopardized, we will work with the parties to attempt to resolve problems. Subcontractors always have the option of requesting relief from the mortgagee or bonding company.

There are provisions for payment to contractors for building components stored offsite; however, prior approval by the Department is required. The law was changed to permit progress payments to be made for building components stored offsite in recognition of the savings that often result from the timing of the purchase and storage of major building components offsite. Building materials common to the various trades are expected to be stored on-site. Contractors and subcontractors may elect to purchase materials and store them offsite, but HUD will not approve progress payments for such materials until they are brought on-site or actually installed in the project.

We trust that your other concerns were associated with isolated cases. The absence of an employee from a HUD Field Office should not interrupt the flow or progress of the work. HUD's mortgage credit personnel are instructed that tap fees and other fees, when applicable, are approved when actually due and payable and supportable by billings.

I hope this information is satisfactory to you.

Very sincerely yours,

R. Hunter Cushing
Deputy Assistant Secretary for
Multifamily Housing Programs

ATTACHMENT D

HUD-5370
Page 3 of 13
March 1973

GENERAL CONDITIONS

1. DEFINITIONS

a. The "Contract" means the Contract executed by the LHA and the Contractor, of which these General Conditions form a part.

b. The terms "LHA" or "Local Authority" and "Contractor" mean the respective parties to the Contract.

c. The term "HUD" means the United States of America (acting through the Department of Housing and Urban Development) which (subject to the provisions of a contract for financial aid with the LHA) has agreed to purchase certain obligations of the LHA to aid in financing the work to be performed under the Contract. However, nothing contained in the Contract shall be construed to create any contractual relationship between the Contractor and HUD.

d. The term "Project" means the housing project, the construction work for which is contemplated in whole or in part under this Contract.

e. The term "Architect" means the person, firm, or corporation under contract with the LHA for architectural-engineering and other services related to the work as provided for in the Contract.

f. The term "Contracting Officer" means the person within the LHA's organization duly authorized by the governing body thereof to administer construction contracts for, and in the name of, the LHA. It does not necessarily mean the person executing this Contract. The LHA shall advise the Contractor as to the person or official who is designated Contracting Officer.

g. The term "Specifications" means the volume which includes, and the term shall include, the Instructions and Forms (consisting of the Form of Invitation for Bids, Instructions to Bidders, Form of Bid, Form of Bid Bond, Form of Non-Collusive Affidavit, Form of Contract and Form of Performance and Payment Bond or Bonds), the General Specifications (consisting of the General Conditions, the Special Conditions, and the Schedule of Drawings) and the Technical Specifications.

h. The term "Drawings" means the Drawings enumerated in the Schedule of Drawings.

2. CONTRACTOR

a. Except as otherwise specifically stated in the Contract, the Contractor shall provide and pay for all materials, labor, tools, equipment, water, light, heat, power, transportation, superintendence, temporary construction of every nature, taxes legally collectible because of the work, and all other services and facilities of every nature whatsoever necessary to perform the work to be done under the Contract and deliver it complete in every respect within the specified time.

b. The Contractor shall personally supervise the work or have a competent superintendent on the work at all times during progress with full authority to act for the Contractor. The Contractor shall also provide a staff adequate to coordinate and expedite his work and that of his subcontractors to ensure compliance with contract requirements.

c. The Contractor may authorize his superintendent or other individual to sign for him and in his name, if the contractor has filed with the LHA a notarized statement evidencing such authorization and authenticating the signature to be so honored.

d. The Contractor shall lay out the work and be responsible for all lines, levels and measurements of all work executed under the Contract. He shall verify the figures before laying out the work and will be held responsible for any error resulting from his failure to do so.

3. SUBCONTRACTS

a. The Contractor shall not contract with any proposed subcontractor who has not been accepted by the LHA.

b. As soon as practicable prior to the award of each subcontract, the Contractor shall notify the LHA in writing of the name of each subcontractor proposed, and furnish such written information as it may require concerning the proposed subcontractor, together with the proposed subcontractor's non-collusive affidavit in the form prescribed by the LHA. Any objection shall be expressed in writing by the LHA within ten (10) days after receipt.

c. The LHA may, without claim for extra cost by the Contractor, disapprove any subcontractor for cause on the basis of its own determination or because of the fact that the proposed subcontractor is listed as ineligible to receive awards of contracts from the United States on a current list or lists furnished by HUD.

d. The Contractor shall be as fully responsible for the acts and omissions of his subcontractors, and of persons either directly or indirectly employed by them as he is for the acts and omissions of persons directly employed by him.

e. The Contractor shall cause appropriate provisions to be inserted in all subcontracts relative to the work to bind subcontractors to the terms of the General Conditions, Special Conditions, and other documents comprising the Contract in so far as they are applicable to the work of subcontractors. The Contractor shall insert in each of his subcontracts the provisions (appropriately modified) of paragraphs 27, (and with respect to subsection 27f(2), copies of 29 CFR 5a.4, 5a.5, 5a.6 and 5a.7 shall be attached) 29, 30, 31, 32, 33 and 34, of these General Conditions.

f. Nothing contained in the Contract shall create any contractual relation between any subcontractor and the LHA.

4. OTHER CONTRACTS

The LHA may award other contracts for additional work, and the Contractor shall fully cooperate with such other

ATTACHMENT E

New Section

REQUIREMENTS FOR FEDERALLY ASSISTED ACTIVITIES

(a)(1) The head of the agency shall prescribe standards for use by grantees, loan recipients or mortgage guarantors to provide that payments under contracts and subcontracts made possible by the federal assistance will substantially comply with the requirements for prompt payment prescribed in Sections 3901 through 3905 of title 31, of the United States Code.

(a)(2) The head of the agency shall include procedures by the agency

(A) to authorize release of funds,
(B) to make or to approve certifications,
(C) to make recommendations on payment applications, or
(D) to expedite the processing and payment of billings.

(a)(3) The procedures described in (a)(2) shall be consistent with enabling grantees, loan recipients or mortgage guarantors to comply with the standards established pursuant to (a)(1).

(b) An obligation to pay an interest penalty to a contractor or subcontractor pursuant to agency standards established under subsection (a) may not be construed to be an obligation of the United States. A grantee, loan recipient, mortgage guarantor, contractor or subcontractor may not obtain reimbursement from the United States for such interest penalty and may not request a contract modification or a cost reimbursement for the purpose of obtaining reimbursement of such interest penalty.

ATTACHMENT F

Amendment to Section 5

by striking (4)(B), and
by inserting after clause (4)(A) the following new clauses
(B) and (C)

(B) any amounts which have been retained during the performance of the contract and are due to be released to the contractor be placed in an escrow account at prevailing interest rates after substantial completion of the construction; and

(C) amounts placed in the escrow account and accumulated interest will be released to the contractor after final acceptance of the construction,

ATTACHMENT G

Attachment

WATCO CORPORATION
MECHANICAL CONTRACTORS

NATIONAL ASSOCIATION OF
PHCC
PLUMBING-HEATING-COOLING
CONTRACTORS

HVAC-Sheetmetal
Metal Fabrication
Industrial Piping
Process Piping
Ultra Pure Piping

May 13, 1986

Honorable Paul S. Trible, Jr.
U. S. Senate
Washington, D.C. 20510

Dear Senator Trible:

It was an exciting and most delightful experience to have talked with you while in Washington at the Legislative Conference on Tuesday, 22nd of April. I sincerely appreciate your invitation to send to you documentations on actual projects where prompt payment to subcontractors is involved at this very time.

Our people, from the floor, tried to impress upon you that your bill only required the owner or the government agency to promptly pay the contractor, which in your bill is the general contractor. We, the subcontractors, who perform over eighty (80%) percent of the actual work on these jobs, stand to wait many months and even years after their phase of work is completed before being paid.

Your bill should at least say pay all CONTRACTOR or each SUBCONTRACTOR his just payment. I spoke with you about making "LINE ITEM PAYMENT" being included in your bill and you stated you wanted some documented evidence as to what I was talking about on the subject.

Sir, I have attached a project that is now still ongoing that I would appreciate your review and study thereof in respect as to WATCO CORPORATION having completed their phase of work satisfactorily well over a year ago and we still have not been paid.

Can't you see by these documents that as long as the General Contractor does not complete his omissions and deletions, he does not have to pay his subcontractors. Your bill is of little value to the mass or volume of the REAL people who ACTUALLY do the work on the projects.

You spoke about taking one step at a time with your bill and having the general contractor paid promptly. You said that once we got the general contractor paid promptly we could then work on getting a pass through to the subcontractors who do the majority of the work. Just how long do you think many of the small subcontractors could hold out with several jobs with the federal government at ten thousand ($10,000.00) plus on each job for years before being paid?

WATCO CORPORATION
P.O. BOX 28716 RALEIGH, NORTH CAROLINA 27611 (919) 772-7191

ATTACHMENT G
Continued

Honorable Paul S. Trible, Jr.
Page Two

How long do you think you could hold out if you were not paid by line item or each job that you performed for your client?

If you have any need or think that I can be of service to you or your committee to help you or your colleagues understand LINE ITEM PAYMENT or prompt payment to the subcontractor, I will be more than happy - upon invitation - to come to Washington and talk to you about this subject.

Most respectfully,

WATCO CORPORATION

John Ward

John A. Ward, Jr.
Chairman of the Board

JAW/cls

Enclosure

ATTACHMENT G
Continued

WATCO CORPORATION
MECHANICAL CONTRACTORS

HVAC-Sheetmetal
Metal Fabrication
Industrial Piping
Process Piping
Ultra Pure Piping

May 14, 1986

Log [illegible] Project:
Contract No.: DACA21-83-C-0111
Prime Contractor: BaHeast Construction Co. Inc.
Title of Project: E.M. Barracks
Location: Fort Bragg, N.C.
Bonding Company: United States Fidelity Guaranty Co.
Name and Address: 456 N. Meridian Street
Indianapolis, Ind. 46204

Contract Status

Issued: 29 Dec 1983
Signed: 4 Jan 1984
Returned: 12 Jan 1984
Completed: 10 Apr 1985

SUMMARY: As of this date, 14 May 1986, WATCO CORPORATION has satisfactorily completed their phase of work on this project and billed final on 10 April 1985, some thirteen months ago. Why should any subcontractor have to be subjected to this type of system at no interest? This is a prime example of why we need LINE ITEM PAYMENT on all projects.

WATCO CORPORATION
P.O. BOX 26716 RALEIGH, NORTH CAROLINA 27611 (919) 772-7191

ATTACHMENT H

LIST OF FAR PROVISIONS

REQUIRED TO BE PASSED-THROUGH TO SUBCONTRACTORS

1. FAR 52.202-1 — DEFINITIONS
2. FAR 52.236-8 — OTHER CONTRACTS
3. FAR 52.236-7 — PERMITS AND RESPONSIBILITIES
4. FAR 52.203-3 — GRATUITIES
5. FAR 52.203-5 — COVENANT AGAINST CONTINGENT FEES
6. FAR 52.228-5 — INSURANCE — WORK ON A GOVERNMENT INSTALLATION
7. FAR 52.236-21 — SPECIFICATIONS AND DRAWINGS FOR CONSTRUCTION
8. FAR 52.236-15 — SCHEDULES FOR CONSTRUCTION CONTRACTS
9. FAR 52.236-5 -- MATERIAL AND WORKMANSHIP
10. FAR 52.236-14 — AVAILABILITY AND USE OF UTILITY SERVICES
11. FAR 52.236-10 -- OPERATIONS AND STORAGE AREAS.
12. FAR 52.236-9 — PROTECTION OF EXISTING VEGETATION, STRUCTURES, EQUIPMENT, UTILITIES, AND IMPROVEMENTS
13. FAR 52.236-13 — ACCIDENT PREVENTION
14. FAR 52.236-12 -- CLEANING UP
15. FAR 52.245-3 — IDENTIFICATION OF GOVERNMENT-FURNISHED PROPERTY
16. FAR 52.246-12 -- INSPECTION OF CONSTRUCTION
17. FAR 52.225-5 — BUY AMERICAN ACT —CONSTRUCTION MATERIALS
18. FAR 52.208-1 — REQUIRED SOURCES FOR JEWEL BEARINGS AND RELATED ITEMS
19. FAR 52.247-63 — PREFERENCE FOR U.S. - FLAG AIR CARRIER
20. FAR 52.247-64 — PREFERENCE FOR PRIVATELY OWNED U.S. - FLAG COMMERCIAL VESSELS
21. FAR 52.223-2 — CLEAN AIR AND WATER
22. FAR 52.222-26 — EQUAL OPPORTUNITY
23. FAR 52.222-35 — AFFIRMATIVE ACTION FOR SPECIAL DISABLED AND VIETNAM ERA VETERANS

7

ATTACHMENT
Continued

PROVISIONS cont.

24. FAR 52.222-36 -- AFFIRMATIVE ACTION FOR HANDICAPPED WORKERS
25. FAR 52.222-27 -- AFFIRMATIVE ACTION COMPLIANCE REQUIREMENTS FOR CONSTRUCTION
26. FAR 52.219-8 -- UTILIZATION OF SMALL BUSINESS CONCERNS AND SMALL DISADVANTAGED BUSINESS CONCERNS
27. FAR 52.219-9 -- SMALL BUSINESS AND SMALL DISADVANTAGED BUSINESS SUBCONTRACTING PLAN
28. FAR 52.219-13 -- UTILIZATION OF WOMEN-OWNED SMALL BUSINESSES
29. FAR 52.220-3 -- UTILIZATION OF LABOR SURPLUS AREA CONCERNS
30. FAR 52.220-4 -- LABOR SURPLUS AREA SUBCONTRACTING PROGRAM
31. FAR 52.243.4 -- CHANGES
32. FAR 52.214-26 -- AUDIT - FORMAL ADVERTISING
33. FAR 52.214-27 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING
34. FAR 52.214-28 -- SUBCONTRACTOR COST OR PRICING DATA - MODIFICATIONS - SEALED BIDDING
35. FAR 52.215-2 -- AUDIT - NEGOTIATION
36. FAR 52.215-22 -- PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA
37. FAR 52.215-24 -- SUBCONTRACTOR COST OR PRICING DATA
38. FAR 52.215-1 -- EXAMINATION OF RECORDS BY COMPTROLLER GENERAL
39. FAR 52.232-17 -- INTEREST
40. FAR 52.249-10 -- DEFAULT TERMINATION OF THE CONTRACTOR
41. FAR 52.233-1 -- DISPUTES
42. FAR 52.204-2 -- SECURITY REQUIREMENTS
43. FAR 52.222-4 -- CONTRACT WORK HOURS AND SAFETY STANDARDS ACT - OVERTIME COMPENSATION-GENERAL
44. FAR 52.223-3 -- HAZARDOUS MATERIAL IDENTIFICATION AND MATERIAL SAFETY DATA
45. FAR 52.227-4 -- PATENT INDEMNITY-- CONSTRUCTION CONTRACTS
46. FAR 52.227-1 -- AUTHORIZATION AND CONSENT
47. FAR 52.227-2 -- NOTICE AND ASSISTANCE REGARDING PATENT AND COPYRIGHT INFRINGEMENT
48. FAR 52.243-3 -- VALUE ENGINEERING - CONSTRUCTION
49. FAR 52.22301 -- CLEAN AIR AND WATER CERTIFICATION

ATTACHMENT I

INTERSTATE MECHANICAL, INC.
2609 S.E. SIXTH AVE., PORTLAND, OREGON, 97202 • 503/233-7171

October 26, 1983

Mr. Marvin Saunders, OMB
Finance Accounting Division
Room 10235
New Executive Office Building
Washington, D.C. 20503

Re: Prompt Payment Act

Dear Mr. Saunders:

I regret to inform you that Interstate Mechanical, Inc. has seen no improvement in the amount of time required for the General Service Administration to pay their bills.

In fact, on progress payments it has become worse instead of better. The General Service Administration now sends someone to the job site to make an estimate of the percentage completion for progress payments. We repeatedly requested the opportunity to meet the inspector on site to substantiate our progress billings. We were denied such opportunities. Regardless of what we have billed, we are paid the amount estimated by the government. This practice has created numerous problems in our accounting system and cash flow, as we have the responsibility to pay all bills related to each progress billing on time.

Final payment on any construction job with the General Service Administration is extremely slow. I believe this delay is largely due to a practice of a complete job review of all material submittals, equipment, and change orders by some other General Service Administration construction management engineer than originally handled the project. This may be a good safeguard for the government to insure that they got everything they paid for, but I don't believe that this should be at the contractor's expense.

Interstate Mechanical, Inc. is seriously considering the discontinuation of bidding construction projects under the jurisdiction of the General Service Administration, because of their practice of slow payment, delays in construction due to the slow response of material approvals, slow response on change order approvals, and the length of time required to close a project.

AIR-CONDITIONING • ENGINEERING • PLUMBING • SERVICE

ATTACHMENT I
Continued

Page 2

I have enclosed a summary of the billing and payment on a project recently completed by Interstate Mechanical, Inc. for your review.

If you have any questions or need further input on this matter, please do not hesitate to give me a call.

Sincerely,

INTERSTATE MECHANICAL, INC.

William L. Harvey

William L. Harvey
President

WLH:rcd

encl.
cc: Senator Bob Packwood
259 Russell Building
Washington, D.C. 20510

cc: Dennis Lavallee/NAPHCC
Government Affairs Director
1016 20th Street N.W.
Washington, D.C. 20036

ATTACHMENT I
Continued

Project No. ROR 06045
Contract No. GS-10B-E-02420-00

Portland, Oregon
GSA---CUSTOM HOUSE
HVAC Modifications

DATE	INVOICE #	AMOUNT BILLED	RETENTION	NET BILLED	PAYMENT	CHECK #
12/17/81	13388	$8,538.00	$426.90	$8,111.10		
12/24/81	13413	12,634.93	631.75	12,003.18		
01/20/82					$12,202.40	111463305
01/26/82	13438	9,746.56	487.33	9,259.23		
02/04/82					13,197.60	61187822
02/27/82	13495	16,259.00	812.95	15.446.05		
03/13/82					16,788.00	11534614
04/22/82	13606	11,657.00	582.85	11,074.15		
05/12/82					5,591.51	082359012
05/25/82	13680	14,722.00	736.10	13,985.90		
06/18/82					16,357.10	79552694
06/29/82	13748	39,396.10	1,969.81	37,426.29		
07/29/82	13785	31,377.00	1,568.85	29,808.15		
08/06/82					36,372.82	19554812
08/23/82	13822	4,145.00	207:25	3,937.75		
09/23/82					17,498.70	
09/29/82	13848	1,558.54	77.92	1,480.62		
10/28/82					6,435.00	28496754
01/26/83					6,283.39	82474050
03/24/83					14,471.61	88141490
08/31/83	15542	1,875.04	.00	1,875.04		
10/5/83					6,711.04	1419962
TOTALS		$151,909.17	$7,501.71	$144,407.46	$151,909.17	

Note: This installation was completed and we left jobsite in September of 1982. A completed charge order was not approved for billing until August of 1983, and retainage was not received until October of 1983 - over one year after completion.

ATTACHMENT I
Continued

General Services Administration, Region 10
GSA Center
Auburn, WA 98002

NOV 21 1983

Honorable Bob Packwood
1220 S.W. Third Avenue
Room 385
Portland, OR 97204

Dear Senator Packwood:

Thank you for your letter dated November 10, 1983, on behalf of Mr. William L. Harvey, President, Interstate Mechanical, Inc., of Portland, Oregon.

Before addressing Mr. Harvey's specific complaint on the Portland Custom House project, I will give you some background information on the General Services Administration's procedures for making progress payments on construction contracts. Every contract over $10,000 contains a standard payment clause which states that the Government will make progress payments monthly as the work proceeds, based on estimates of the percentage of the work actually completed. These estimates are made by a Government inspector during an onsite inspection. The contractor is specifically requested to be present at all progress inspections so that a mutually agreeable percentage completion can be determined.

Progress payments are not intended to be payment for work completed by the contractor and accepted by the Government; rather they are made for financing purposes prior to final completion and acceptance of the work. Contractor's invoices are not solicited for progress payments, and if received, they are not considered in the determination of the payment. Because of their nature as a financing method, progress payments are not subject to the provisions of the Prompt Payment Act.

The amount of each progress payment is determined by the Contracting Officer based on the inspector's report. The contractor may not always agree with the amount and he may dispute it; but the Contracting Officer's decision, after considering the contractor's viewpoint, is final. Payments may be reduced for several reasons. Poor workmanship, errors and defects in construction, and violations of the Davis-Bacon Act are the most common reasons. There is also a mandatory 5 percent retainage on all progress payments until the work is completed.

ATTACHMENT I
Continued

Disputes of fact under the contract may result in withholding of funds for several months until the dispute is settled. This was the case in two recent contracts that Mr. Harvey performed for General Services Administration, including the contract mentioned above. The dispute in both contracts concerned the date of actual substantial completion of the contracts. This is the date that the contract is officially accepted by the Government and after which the contractor is no longer liable for liquidated damages for late completion. Normally this date is established at 95 percent completion, but the basic criteria is the earliest date the contract work is usable for its intended purpose.

Mr. Harvey alleges in his letter that his firm completed the Custom House project in September 1982, and left the jobsite. The latter part of that statement is accurate, but not the former. Our records indicate that Interstate personnel were still working in March 1983, in response to a letter from the Contracting Officer directing the firm to complete unfinished work. A copy of this letter is enclosed, along with a letter from Mr. Harvey dated March 24, 1983, informing the Contracting Officer that the work was completed.

There are many other complicating factors involved in this particular contract, but the essential fact is that General Services Administration withheld payments from Interstate for cause. If you or your staff would like further information on this contract, please contact Design and Construction Contracts Branch at (206) 931-7364.

Sincerely,

Robert D. Green

ROBERT D. GREEN
Acting Assistant Regional Administrator for
Public Buildings and Real Property

Enclosures

cc:
Honorable Bob Packwood
United States Senate
Washington, D.C. 90510

PROFESSIONAL
SERVICES
COUNCIL

Representing companies
that are creating the
future through innovation,
technology and ideas

John C. Rennie
President

Virginia Littlejohn
Executive Director

April 3, 1987

The Honorable John Glenn
Chairman
Committee on Governmental Affairs
United States Senate
Washington, D. C. 20510

SUBJECT: S. 328, "THE PROMPT PAYMENT ACT AMENDMENTS OF 1987"

Dear Chairman Glenn:

As you know, John C. Rennie, President and CEO of Pacer Systems, Inc. and the 1987 President of the Professional Services Council (PSC), testified on behalf of both PSC and the National Small Business United (NSBU) at your recent prompt payment hearings. Although his oral remarks reflected the views of both organizations, at that time PSC did not submit formal written testimony.

On behalf of PSC, I am pleased to submit the following comments on S. 328, the proposed "Prompt Payment Act Amendments of 1987".

PSC's membership includes six trade associations and seventy-five companies in the professional and technical services industry, the majority of which are small. PSC members include research and development firms, independent laboratories and test facilities, architect and engineering firms, systems integration and support activities, program analysis and evaluation companies, computer software development companies, engineering houses and public accounting firms, to name a few. Their personnel include engineers, mathematicians, chemists, physicists, statisticians, computer scientists and programmers, artificial intelligence specialists, lawyers, accountants, program analysts, operations research experts, and specialists from numerous other disciplines. The typical member of PSC is actively involved in federal procurement.

STRONG SUPPORT EXISTS FOR LEGISLATION

During the past eighteen months, a number of procurement laws have been enacted or proposed which would have a severely negative impact on the professional services industry's ability to provide professional services of a high quality to its federal customers in a timely, cost-effective way.

These proposals include capping Department of Defense (DoD) appropriations for contractor support services, placing arbitrary limits on executive compensation levels for senior executives serving government contractors, and most recently, significantly reducing contract profit levels for the professional and technical services industry. By way of contrast, the proposed amendments to the Prompt Payment Act represent a very positive improvement in the present process which, if enacted, will treat services companies working for the federal government more equitably.

PSC is pleased to note that the General Accounting Office (GAO) generally agrees with the provisions of S. 328 and supports this Committee's efforts to improve federal efforts to pay contractors in a timely manner. Although its 1986 report establishes that the federal government is doing better, GAO concludes that the performance of federal agencies is still short of what Congress intended in passing the Prompt Payment Act of 1982. During the 1985 test period GAO found that an estimated 24% of federal payments ($7.7 billion) were paid late, while the required interest penalties were seldom paid.

GAO estimates that agencies should have been subjected to 278,000 late payment penalties (approximately $15 million in interest on late payments) during this test period. In addition, GAO estimates that during the four-month test period about 146,000 early payment discounts (approximately $2 million) were taken after the discount period had expired.

The pending legislation would also implement a major recommendation of the 1986 White House Conference on Small Business. The Conference urged that prompt pay legislation be strengthened through amendments to the 1982 Prompt Pay Act and vigorously enforced by all branches of government.

Additionally, during the 99th Congress the Senate Small Business Committee conducted two oversight hearings on the implementation of the Prompt Payment Act which verified that many government contractors are still plagued with untimely payments and related problems in securing reimbursement for legitimate fees and expenses incurred on government contracts, despite the modest improvements in recent years in the bill-paying practices of the federal government. Their 623 pages of printed hearing record has been well utilized by the Committee in considering S. 2479, the "Prompt Payment Amendments of 1986", unanimously reported by this Committee and passed by the Senate in the closing days of the last Congress.

URGENT NEED FOR PROMPT PAY REFORM

One of the most significant aspects of the financial operations of a typical service firm, in particular a smaller firm, is cash flow. The timeliness with which a company can secure payment for its monthly invoices can make the difference between the ultimate success or failure for the smaller company. To state the obvious, cash flow represents the life blood of these types of companies. When the Prompt Payment Act was enacted into law several years ago, many in the government contracting community believed that, at long last, serious attention would be given to the timely payment of government contractor invoices and that the long delays in receipt of payments, which were the accepted practice, would be a thing of the past.

Sadly, the experience has been that agencies have exploited ambiguities and loopholes in the Act to strip away its protections in an ever growing number of cases. The Office of Management and Budget (OMB) has pressured agencies to adopt cash management techniques to hold down interest penalties benefiting the government at the expense of government contractors. When this practice became apparent, OMB witnesses in 1986 testimony before the Senate Small Business Committee and the House Government Operations Committee, promised prompt and effective administrative actions to correct the problem through an amendment to OMB Circular A-125 (Prompt Payment).

As of March, 1987, no proposed revision to OMB Circular A-125 has yet been published for public comment. On March 18, 1987, a day before the Committee's hearing, a proposed amendment to implement the Prompt Payment Act of 1982 to the government-wide Federal Acquisition Regulation (FAR) was published for comment, five years after Congress had requested the rules implementing the Act be promulgated. Very belatedly, the Reagan Administration endorsed the Prompt Payment Act Amendments in S. 328. This history of federal delays and inaction make the need for new legislation more apparent.

In further support of the pending bill, PSC would like to stress that professional services firms have experienced serious problems involving the taking of discounts by the government after the discount period specified in the contractor's invoice, the failure of the government to pay late payment interest penalties when due, and the abuse by the government of the fifteen-day payment grace period. Perhaps the most onerous deficiency in the present Prompt Payment Act is the unlimited time given to the executive agencies to accept the supplies or services provided by the contractor and grant approval for payment of the invoices associated with these supplies or services.

Typically, for an invoice submitted by a company in the professional and technical services industry, the payment clock does not start until a proper invoice is received at the government payment center. However, at many government agencies, a long and time-consuming approval process must transpire before the invoice is considered received at the payment center. This approval process consists of the following steps and time periods:

> First, invoices must be forwarded to the government technical activity's Voucher Payment Office, where the invoice is reviewed for proper content and format and the appropriate approving official is determined. This step can take between two to four days to complete.
>
> Second, invoices are then sent for approval to the designated government technical representative (i.e., COTR). This individual is responsible for ensuring that the manhours, costs and profit/fee amounts claimed are reasonable in relation to the level and amount of services provided during the billing period. Depending upon the availability of the approving official, this step can take between 2 and 21 days. In the event that the COTR is on travel status, on annual leave, on sick leave, attending government training courses, or otherwise involved with technical, program-oriented problems or issues, invoices may literally "sit in the person's in-box" for as long as three weeks.
>
> Third, once the appropriate government technical representative has approved the invoices and certified their legitimacy, invoices are forwarded, usually by regular mail, to the cognizant Defense Contract Audit Agency (DCAA) for provisional audit. Depending upon the relative proximity of the government technical office and the cognizant DCAA, this step can require from 2 to 7 days to accomplish.

Under the present Prompt Payment Act, all of these approval hurdles must be successfully cleared before the invoices are sent to the government payment center and the 45-day (30 days + 15-day grace period) payment clock begins. Taken together, the three-step process described above can add as much as 32 days to the processing cycle for a legitimate professional services invoice.

Thus, with 32 days for approval and 45 days for payment processing and disbursement, the entire process can take nearly 80 days to complete. It should be noted that this 80-day period falls 15 to 30 days after the contractor has actually incurred the cost (i.e., payroll and related expenses) for the services provided.

The total timeframe can be in excess of three months, from contractor payment of expenses to contractor receipt of the cash from the government as reimbursement for such expenses. The significant delay falls in the time period for invoice approval, and represents the area in which the highest level of attention must be directed if the payment process is to be significantly improved.

S. 328 CORRECTS CURRENT DEFICIENCIES

The amendments to the current Prompt Payment Act that are embodied in the Committee's proposed legislation correct many of the deficiencies which exist in the present government payment process. The requirements for double interest penalties on late interest payments to contractors, the phase-out of the 15-day grace period, and the more stringent limitations on discount payments together represent important improvements in the Prompt Payment Act of 1982.

The proposed amendment in Section 3, which deals directly with the definition of agency receipt and which specifies that the head of the agency is deemed to receive an invoice on the later of the actual date of receipt of a proper invoice, or the fifth day after the date on which the property or services are delivered, is a noteworthy move toward a solution for the significant delays present in the agency approval process for contractor invoices.

Amendments in Section 5 of the bill clarify that interest is payable for late progress payments and retained amounts on construction contracts, eliminating interpretation by agencies that the Act does not apply to progress payments.

Section 7 extends the protections of the Prompt Pay Act to subcontractors under federal construction contracts by establishing minimum standards for the payment clause to be included in the subcontract agreement between the prime contractor on a federal construction project and its subcontractors. It also entitles the subcontractor to a late payment interest penalty at the same rate prevailing between the Government and the prime contractor in the event that the prime contractor fails to make timely payment in accordance with their subcontract agreement. The section recognizes the "prevailing industry standard" for payment of subcontractors by the prime contractor within seven days after receipt of payment from the government. We support this provision because timely payments of subcontractors is a sound business practice, and will significantly contribute to the timely completion of the public works being undertaken.

In total, the Prompt Payment Act Amendments of 1987 clearly represent a substantial improvement over current federal practices.

In summary, on behalf of the professional and technical services industry, PSC wholeheartedly endorses the Prompt Payment Act Amendments of 1987 as a constructive effort to improve the government procurement process.

PSC applauds this Committee's continuing efforts on the subject of prompt payment for government contractors and would welcome the opportunity to work with you to ensure passage of this important legislative initiative.

Thank you for this opportunity to comment on the proposed legislation.

Sincerely,

VIRGINIA LITTLEJOHN

Virginia Littlejohn
Executive Director

VL/cav

Statement of the Scientific Apparatus Makers Association
Before the Senate Committee on
Governmental Affairs
on S. 328, Prompt Payment Act Amendments of 1987

On behalf of the Scientific Apparatus Makers Association (SAMA), I would like to express our support for S. 328, the Prompt Payment Act Amendment of 1987.

SAMA is the national trade association of the high technology scientific clinical and process controls instruments industry. SAMA's 230 member companies, many of moderate and small size, manufacture and distribute more than 40,000 types of high technology instruments and related products. That equipment is used for research, production and quality control and for environmental compliance by a wide range of industries, including chemical and pharmaceutical manufacturing, oil refining and food processing. Scientific instruments also are employed in scientific and medical research by hospitals, universities and government agencies including NIH and EPA. SAMA's members have combined annual sales in excess of $14 Billion, and overseas sales account for between 35-40% of total sales.

The Prompt Payment Act was passed by the Congress in 1982 to improve the government's dismal record of untimely payments to its contractors, a situation that had steadfastly resisted administrative resolution. Small businesses are especially hard hit by the financing costs flowing from delayed payments. Essentially, the Act requires the government to pay by the due date specified in its contract or within thirty days in the absence of a contractual due date, or to pay the contractor a late payment interest penalty.

Although the Act went a long way in compelling Federal agencies to improve their bill paying practices, it is also clear that the Act's protections are being denied to many small businesses who provide supplies and services to the government. After four and one-half year's experience under the Act, it is clear that the Federal agencies have successfully identified ambiguities and loopholes in the Act, and have exploited them to avoid the payment of the late payment interest penalties required if they fail to make timely payments.

The extent of the payment problems being suffered by government contractors have been further confirmed by a report issued by the General Accounting Office (GAO) in August of 1986. GAO found that approximately 25 percent of the government's invoices were still being paid after the due date. Early payment discounts, offered by contractors, were being improperly taken. GAO's auditors found unpaid interest penalties at 60 percent of the agency payment centers visited during their review. They found that some of these payment centers even had local policies not to pay a late payment interest penalty known to be due a contractor unless the contractor made a request. GAO found that 20 percent of the invoices which they sampled had been paid during the "grace periods" currently afforded to the government by the Act, during which the agency may pay late without incurring any interest penalty.

We firmly believe that some of the most needed improvements to the Act can only be accomplished through changes to the law. For example, the bill's provisions relating to tightening the time available to the government for acceptance of goods or services before incurring a late payment interest penalty for any delay and the gradual elimination of the "grace periods," are just two needed improvements that require statutory changes.

We hope the Government Affairs Committee will press for swift mark-up of S. 328 so that we may move toward fulfillment of Recommendation 32 of the 1986 White House Conference on Small Business, which calls for a strengthened Act by the various Executive agencies.

The Sheet Metal and Air Conditioning Contractors' National Association, Inc.

SMACNA

STATEMENT OF JAMES E. ROTH

TO

U.S. SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS

ON

S. 328, PROMPT PAY AMENDMENTS OF 1987

MARCH 19, 1987

Mr. Chairman, other members of the Committee, my name is James E. Roth, President of James E. Roth, Inc., Mars, Pennsylvania. I am submitting these remarks as President of the Sheet Metal and Air Conditioning Contractors' National Association, Inc. (SMACNA), representing 5,000 contributing unionized construction companies. I am also current chairman of the Associated Specialty Contractors (ASC) represented on the construction panel today. SMACNA stands solidly behind ASC's remarks before the Committee.

Today I urge your strong support for S. 328, The Prompt Pay Amendments of 1987. We want the record to show that we join others in the construction industry actively supporting this critical legislation, cosponsored by over 70 Senators. As you are aware, current law requiring all federal agencies to pay for goods and services within 45 days has not been as effective as intended. S. 328 will correct a number of the problems our members have in receiving their pay when due. We urge you to strongly support S. 328 with section 7 which would provide long overdue relief for subcontractors now being paid late by general contractors on federal projects. Without this section little progress will be made by passing this legislation.

While SMACNA members frequently function as prime contractors on a project site, most often they are project subcontractors. The major shortcoming in current law is glaringly obvious and most troublesome to subcontractors and their organizations. This is the failure of current law to require prime contractors to pay their subcontractors within a specified date. In other words, current law does not require the benefits of prompt payment to be shared between general and subcontractors. Since the overwhelming majority of work on federal projects is done by subcontractors, it is ironic that they are left out of the prompt pay law. While the general or prime contractor has enjoyed the ability to escape prompt pay requirements to date, that is no reason to continue this inequity for subcontractors. We believe S. 328 offers the best opportunity to correct a practice that has only increased project delays, government costs, subcontractor financial strain and unnecessary inconvenience to small businesses.

Although our members do frequently perform work as prime contractors, we are not fearful of legislation requiring payment to our subcontractors on time. We support the language in S. 328 addressing subcontractor prompt pay. In too many cases our contractors have been forced to seek payment assistance from the agency involved in the project. Once this has failed, they have been forced to seek court action. All this wasted time and trouble costs the subcontractor money and often deters the specialty subcontractor from bidding on government projects.

In many cases, the general contractor denies he has been paid so the subcontractor must take valuable time to institute a collection procedure. A contractor from Iowa informed our office that he was forced to spend a great deal of time and money seeking the help of an attorney and even his U.S. Senator to get paid for a job--a job for which the general contractor had already been paid months earlier. This week another contractor working on a job in New Jersey told us he has waited at least sixty days on more than one occasion for his pay after the general contractor had received his progress payments. There are far too many similar stories of subcontractors suffering due to current law.

One more recent example involves a California subcontractor who was forced as a last resort to communicate with the government agency, his Senators and Representative, to get paid for a project completed many months before. This could be prevented in the future if coverage is extended by section 7 to the subcontractors.

SMACNA also believes that federally assisted construction in the states and localities should be covered by the terms of S. 328, if possible. The logic of paying subcontractors on time for federal work clearly extends to federally assisted contracts as well. Many states pay promptly on state projects and Louisiana law requires prompt payment on all construction work.

SMACNA strongly believes that subcontractors should be paid within seven days after the prime contractor has been paid. If the prime contractor does not pay on time, he should be required to pay a significant interest penalty on the overdue amount. In addition, after the prime contractor has been paid, if three or more payments to subcontractors are late, the contracting agency should pay the subcontractor direct. The seven day payment rule has been jointly adopted by the Associated General Contractors (AGC), the American Subcontractors Association (ASA), and the Associated Specialty Contractors (ASC) of which SMACNA is an active member. SMACNA members not only support this rule, they practice it.

In closing, SMACNA wants to encourage you to reexamine the late payment problem on government projects and urges your sensitivity to the special problem of subcontractors. S. 328 with section 7 is a valuable step in the right direction. If passed, it will do much to provide overdue relief to the many subcontractors currently at risk when working on government contracts.

Thank you.

Malcolm Wallop
Wyoming

United States Senate
WASHINGTON, D.C. 20510

Committees:
Energy and Natural Resources
Finance
Small Business
Commission on Security
and Cooperation
in Europe

March 6, 1987

The Honorable John Glenn
Chairman
Senate Committee on Governmental Affairs
SD-340
Washington, D.C. 20510

Dear Mr. Chairman:

It has come to my attention that your committee has scheduled hearings on S. 328, the Prompt Payment Act Amendments of 1987, which requires the federal government to pay interest on overdue payments. I am a cosponsor of this legislation.

The purpose of my letter is to call your attention to section 7 of this bill and to share with you a letter I received from Rick Gilpatrick of Gilpatrick Construction Company, Inc., who is also the current president of the Associated General Contractors of Wyoming. As you will note from his letter, Mr. Gilpatrick expresses his concern, and that of the Associated General Contractors about the affect this provision would have on the contractor/subcontractor relationship. Mr. Gilpatrick believes that this provision would negate the exclusive privity of contract between the general contractor and subcontractor and embroil the federal government in payment disputes between the general contractor and subcontractor.

I would appreciate it if your committee could review Mr. Gilpatrick's comments and attempt to address the specific points he raises in his letter. I would also appreciate it if you could make his letter a part of the hearing record.

Thank you for your attention to this matter. I look forward to hearing from you.

Sincerely,

Malcolm Wallop

Malcolm Wallop
United States Senator

MW/mj
Enclosure

GILPATRICK CONSTRUCTION COMPANY, Inc.

AREA 307-856-2229 ● 714 WEST MONROE ● RIVERTON, WYOMING 82501

1987 FEB 23 AM 8:58
Feb 23

February 9, 1987

The Honorable Malcolm Wallop
United States Senator
Senate Office Building
Washington, D.C. 20510

Dear Senator Wallop:

In the last Congress, Associated General Contractors strongly supported amendments to the Prompt Pay Act of 1982, to ensure that progress payments or federal construction contracts are specifically covered by the law and that the government must pay interest to its contractors when it is late in making such payments. Passage of these needed amendments, however, was burdened by the inclusion of provisions mandating payment procedures or subcontracts. Once again, in the new Congress, we will support the amendments to the Prompt Pay Act. Attempts are being made to involve the federal govenment in private contractual matters. Associated General Contractors, in the Congress, as in the past will vigorously oppose the subcontract payment provision. Here are ten reasons why we, as an association, and I, as an independent contractor, would not like to see this Section 7 of Senate Bill 328 pass:

1. The government enters into one contract with one party for the construction of one project. That single contract is with the general contractor. It is with the general contractor alone that the government has a privity of contract. Consequently, as a well-settled matter of federal procurement law, the government, because of the privity of contract, looks solely to the general contractor for total performance.
2. Privity of contract protects the government since it need look to no other party to ensure itself the bargained-for performance. Privity also prevents the government from inadvertantly assuming responsibility to other parties since the government is not permitted to intrude in any of its contractor's private relationships.
3. Enactment of the subcontract payment provision would constitute an unwarranted intrusion into the private contracts between general contractors and subcontractors. There is no need for the government to micromanage its projects.
4. Enactment of the subcontract payment provision would embroil the government in claims between the general contractor and subcontractor.
5. Enactment of the subcontract payment provision could foster more claims and force the cost of government construction to rise.
6. No evidence has been presented to show that subcontract payment problems are prevalent on federal projects. To the extent subcontact payment may not occur, no evidence substantiates payment problems other than when general contractors have not been paid by the federal agency. No evidence has been presented to show that the subcontract private contractual remedies are inadequate.

7. The construction industry already fully supports prompt payment of subcontractors as reflected in private industry documents including AGC contract documents and AGC subcontractor payment guidelines.
8. The general contractor, for the protection of the government, provides payment and performace bonds as required security. Often, subcontractors do not provide security in the form of bonds, or otherwise, to protect the general contractor. Consequently, the general contractor must be able to exercise maximum flexibility in the determination of subcontractor performance and payment to protect itself and, in turn, the government owner.
9. Subcontractors have adequate payment protection available to them under the Miller Act and other legal and equitable remedies against the contractor.
10. Enactment of the subcontract payment provision would subvert the general contractor's ability to manage and control the government construction contact.

In summary, Prompt Pay is clearly not the issue, since the industry-wide model subcontracts already provide for same. What is at issue is whether the federal government should force itself into a private contractual relationship and dictate the payment terms in that private contractual relationship. The subcontract payment provision holds significance beyond its immediate direct onerous consequences. The mandated federal intrusion in subcontract payment provisions appears to be only a first step toward federally mandated direct payment to subcontractors and federally mandated separate contracts.

In the past fifty years that we have been in business, we have experienced no problems with payment either as a subcontractor to another prime or as a prime ourselves to our subcontractors.

We urge you to take amother look at this bill and consider some of our views.

Sincerely,

GILPATRICK CONSTRUCTION CO., INC.

Richard M. Gilpatrick
Secretary-Treasurer

RMG/ mw

ELECTRIC, inc.
388 N. WAREHOUSE ROAD • CASPER, WYOMING 82601 • PH. 307/577-9114

March 30, 1987

Senator Malcom Wallop
United States Senate
Washington, D.C. 20510

Ref: S.328 (Prompt Payment Act Amendments of 1987)

Dear Senator Malcom Wallop;

Although aware of S.328, I have previously not thought it a controversial issue needing yet another letter. Alas, this is not the case since Senator Wallop submitted a letter from the AGC into the record.

This letter is being written to present the other side of the issue; that of the Subcontractor's.

In 1982 the Prompt Payment Act was passed, requiring the federal government to pay it's bills within 45 days, or face late payment charges from the 30th day. This did not solve the problem, as evidenced in the hearings by the Senate Small Business Committee in 1985 and 1986. Further modifications were done through the Prompt Payment Act Amendments of 1986, in the form of S.2479, and the 1987 version being S.328.

The intent is still to insure the vendor, or contractor being paid rightfully due funds in a reasonable length of time. Section 7 of this legislation offers protection to the Subcontractor in the event the General, or Prime Contractor does not pay his Subs in "Prevailing Industry Standard" (currently interpreted as 7 days). I feel this is only fair.

Contrary to the AGC's position, this clause does not adversely interfere with Contractor/Subcontractor relationship.

I have had frequent, personal experience on federal projects where legislation of this type would have been cost effective for not only our firm, but the owner. All federally funded projects are "One-Contract-Bid", meaning I, as a Subcontractor, turn my bid into the general contractors, some of whom I have not worked with, therefore do not know. Our biggest concern with unknown contractors is our cash flow.

I must meet payroll weekly, some taxes monthly, others quarterly. As you know, if I am one day late with my taxes, I am assessed an extremely high penalty. Yet I have performed work on federal projects (V.A. Hospital; Sheridan, WY., Evanston Waste Water Treatment Plant, Evanston, WY., U.S. Forest Service, Sheridan, WY., Bureau of Reclamation, Alcova

Power Plant, WY) where I have had to beg, plead, threaten and even file claims due to non payment by the General Contractor, when they freqently have received their payment.

It is unfortunately a common occurance for a contractor to tell our office that they have not received payment, when the contrecting officer has in fact confirmed payment.

The ultimate objective of the construction industry, as well as the "owner" (in this case the federal government) is cost-effective construction. The current economic conditions dictate "cheap", which is already compromising quality. When the subcontractors and suppliers (which compromise at least 75% of the funds invested in construction) are not assured of prompt and reasonable payment, further compromise results. Either costs are escallated to absorb the additional risk, or uninformed, or less "quality" businesses are encouraged. Anything done to improve the construction industry must be done to the entire industry, and for the benefit of the entire industry.

All I am asking for is some assurance of equality in business; If prompt pay is good for the prime contractor, let the subcontractors have it too.

Respectfully,
A & E ELECTRIC, INC.

Emeric Solymossy
President

cc: Senator John Glenn
ASA
ABC